

## **NOTICE OF PUBLIC MEETING**

This notice is given to meet the requirements of the S.C. Freedom of Information Act and the Americans with Disabilities Act. Furthermore, this facility is accessible to individuals with disabilities, and special accommodations will be provided if requested in advance.

### **RETIREMENT SYSTEM INVESTMENT COMMISSION**

Date: May 1, 2014

Time: 9:00 am

Location: The Capitol Center

1201 Main Street

Columbia, South Carolina 29201

Meeting Room: Presentation Center

- I. Call to Order and Consent Agenda – 9am
  - A. Adoption of Proposed Agenda
  - B. Approval of Minutes
- II. Securities Lending – 9:10am
- III. Chairman's Report – 9:50am
  - A. Distribution of Commission Evaluation Materials

Break

- IV. Fiduciary Audit Presentation --10:00am
- V. Lunch – Noon
- VI. CIO's Report – 12:15
  - A. Investment Performance Update and Review
  - B. Annual Investment Plan (AIP) Vote
  - C. Penn Short Duration
- VII. Committee Reports -- 1pm
  - A. Ad Hoc Planning Committee
  - B. Audit Committee
  - C. Compensation Committee
  - D. Ad Hoc Nominating Committee
    - 1. Election of Officers
- VIII. Executive Session to discuss personnel matters, and investment matters pursuant to S.C. Code Ann. Sections §§ 9-16-80 and 9-16-320 2:30pm
- IX. Adjournment

**South Carolina Retirement System Investment Commission  
Meeting Minutes**

**March 13, 2014**

**15th Floor Conference Room  
1201 Main Street  
Columbia, South Carolina 29201**

**Commissioners Present:**

Mr. Reynolds Williams, Chairman  
Mr. Edward Giobbe, Vice Chairman  
State Treasurer Curtis M. Loftis, Jr. (via telephone)  
Dr. Rebecca Gunnlaugsson  
Mr. Allen Gillespie  
Dr. Ronald Wilder  
Mr. Travis Turner

**Others present for all or a portion of the meeting on Thursday, March 13, 2014:**

Mike Addy, Ashli Aslin, Josh Brade, Betsy Burn, Alexander Campbell, Andrew Chernick, Sarah Corbett, Dori Ditty, Robert Feinstein, Brenda Gadson, Monica Houston, Adam Jordan, Dave Klauka, Doug Lybrand, James Manning, Steve Marino, Bryan Moore, Weiyi Ning, David Phillips, Jon Rychener, Greg Ryberg, Kathleen Shealy, Nancy Shealy, Lorrie Smith, Danny Varat, and Brian Wheeler from the South Carolina Retirement System Investment Commission; Faith Wright and Tammy Nichols from the Public Employee Benefits Authority; Clarissa Adams, and Robin Johnson from the State Treasurer's Office; Alexandria Patrick from Creel Court Reporting; Wayne Bell, Wayne Pruitt, Sam Griswold, and Donald Tudor from the State Retirees Association of South Carolina; Suzanne Bernard, Brady O'Connell, and Phil Kivarkis from Hewitt EnnisKnupp, Inc.; Jim Lockhart from WL Ross & Co, LLC.; Michael Luppe from Push Digital; and Matt Iovanina.

**I. CALL TO ORDER AND CONSENT AGENDA**

Chairman Reynolds Williams called the meeting of the South Carolina Retirement System Investment Commission ("Commission") to order at 10:07 a.m. Chairman Williams referred to the proposed meeting agenda, and asked to amend the agenda by moving agenda item VII, *CIO's Report* to precede agenda item III on the draft agenda. Chairman Williams asked for a motion to approve the revised agenda. Mr. Allen Gillespie made a motion, which was seconded by Dr. Ronald Wilder and passed unanimously, to approve the agenda as amended.

Chairman Williams referred to the revised draft minutes from the October 11, 2013, Commission meeting and asked for a motion to approve. Dr. Rebecca Gunnlaugsson made a motion, which was seconded by Mr. Edward Giobbe to approve the meeting minutes from the October 11, 2013 Commission meeting as amended. Mr. Gillespie asked that the October 11, 2013 meeting minutes be carried over based on recommendations by Mr. Curtis Loftis to add more detail to the minutes from comments he made during the October 11 Commission meeting. Chairman Williams noted that the revised October 11, 2013 minutes were distributed to all Commissioners on February 21, 2014. Following additional discussion, the motion passed with a vote of 4-1, with Chairman

Williams, Mr. Giobbe, Dr. Gunnlaugsson, and Dr. Wilder voting for the motion, and Mr. Loftis voting against the motion. Mr. Gillespie abstained from voting.

Chairman Williams referred to the draft minutes from the November 21, 2013 Commission meeting and asked for a motion to approve. Dr. Gunnlaugsson made a motion, which was seconded by Dr. Wilder and passed unanimously, to approve the meeting minutes from the November 21, 2013 Commission meeting.

## **II. CHAIRMAN'S REPORT**

Chairman Williams reminded the Commission that the deadline for filing the Statement of Economic Interest report online with the South Carolina State Ethics Commission is March 31, 2014.

Chairman Williams asked the Commission to provide changes to the proposed Fiscal Year 2014-2015 Annual Investment Plan ("AIP") by April 11, 2014 to allow for the final AIP to be adopted on May 1, 2014. Chairman Williams announced that the next Commission meeting will be May 1, 2014.

Chairman Williams stated that the Funston Fiduciary Audit Report is nearing completion and that Funston would present the final report at the May 1, 2014 meeting. The Chairman noted that a preliminary audit report had been received and he opined that the Commission, as a whole, will be pleased with the results of the final fiduciary audit report.

Chairman Williams requested to appoint an Ad Hoc Committee to review and implement the recommendations set forth in the Funston Fiduciary Audit Report. Chairman Williams made a motion, which was seconded by Mr. Giobbe and passed unanimously, to:

1. Adopt the recommendation of the Chairman to create an Ad Hoc Committee to review the recommendations set forth in the Funston Fiduciary Audit Report and, in collaboration with RSIC Staff, develop a strategic plan; and
2. Ratify the Chairman's selection of Dr. Gunnlaugsson, Dr. Wilder and Mr. Williams to serve as members of the Committee. Note: In accordance with the Commission's Governance Policies, the Committee's members will select a chairman.

Mr. Loftis abstained from voting.

Chairman Williams then made a motion, which was seconded by Dr. Wilder and passed unanimously, to adopt the recommendation of the Chairman to create an Ad Hoc Nominating Committee for the purpose of receiving nominations to serve as the Commission's Vice Chairman for a two-year term commencing July 1, 2014 and ending June 30, 2016 and to ratify the Chairman's selection of Mr. Giobbe and Mr. Williams to serve as members of the Committee. Mr. Loftis abstained from voting.

Chairman Williams made a second motion, which was seconded by Mr. Gillespie and passed unanimously, to select Mr. Giobbe to serve as the Committee's chairman. Mr. Loftis abstained from voting.

Chairman Williams introduced and welcomed Mr. Travis Turner, Interim Executive Director of the Public Employee Benefit Authority ("PEBA"), as the newest member of the Commission.

Chairman Williams noted that Mr. Turner would serve as a non-voting, ex officio member of the Commission, and he will also serve on the Audit Committee.

Mr. David Phillips, Deputy Chief Investment Officer, introduced Mr. Alexander Campbell, Investment Analyst, as the newest member of the Investment Team.

Ms. Sarah Corbett, Director of Operations and Due Diligence, introduced Mr. Scott Forrest, Operational Due Diligence Officer, as the newest member of the Operational Due Diligence team.

Chairman Williams opined that the Commission and Staff have helped to create the most transparent, accountable, and efficient body of government that he has ever seen. Chairman Williams stated that even though the Commission inherited major obstacles, these complexities have been handled from the inception with the highest level of diligence and fiduciary responsibility. Chairman Williams noted that he would like his testimony at the Senate Finance Committee to be attached as an exhibit to the record of this Commission meeting.

Chairman Williams stated that he had asked Mr. Hershel Harper, Chief Investment Officer ("CIO"), to begin developing a strategic planning retreat for June 2014. Chairman Williams noted that Mr. Harper was not able to attend this Commission meeting because he and his wife were awaiting the birth of their second child.

### **III. CIO'S REPORT**

Chairman Williams recognized Mr. Phillips for the Chief Investment Officer ("CIO") Report. Mr. Phillips stated that the investment team has 21 full-time ("FTE") positions, with four open positions and 17 filled.

Mr. Phillips reviewed the 2013-2014 AIP initiatives regarding global equity, core and global fixed income, diversified credit, and hedge funds. Mr. Phillips stated that the transition to the global equity passive index managers was in the final stages of implementation, and Staff will be reviewing and revising the guidelines for the global fixed income managers. Mr. Phillips reported that the transition away from portable alpha had been completed, and the Portfolio was moving towards a more conservative portfolio implementation. Mr. Phillips stated that the simplification and consolidation of external manager allocations had made progress, and the internal passive enhanced indexing strategies using basket trades and exchange traded funds had been implemented. Mr. Phillips reported that significant progress had been made in redesigning the strategic partnership model and standardizing strategic partnership policies. Mr. Phillips also updated the Commission on Scout Partners, a concentrated equity manager, to which the Commission had allocated \$150 million. He reported that Scout had announced to investors in January 2014 that the firm will be returning capital and winding down operations. Mr. Phillips noted that the ending value for the portfolio's investment in Scout was in excess of \$200 million, which corresponds to a 12.1 percent annualized return, with an annualized alpha of 3.3 percent, net of fees, and stated that, overall, Scout had been a high performing manager. Mr. Phillips noted that hedge fund exposures had been reduced by over \$700 million, with an additional \$300 million of redemptions coming through in March and April.

Mr. Phillips provided key updates on internal management and research, risk management, strategic partnerships, and policy target ranges. Mr. Phillips stated that the fiscal year-to-date Plan performance estimate was 10.6 percent, relative to the policy benchmark estimate of 10.1 percent, for a 50 basis point incremental outperformance. Mr. Phillips advised that the Plan returned 8.8 percent halfway through the fiscal year as of December 31, 2013, versus the policy

benchmark of 8.4 percent. Mr. Phillips reviewed Portfolio exposures relative to target allocations, and stated that the Portfolio was most significantly overweight in the hedge fund low beta category, and mixed credit category, and underweight in emerging market debt, and private debt. Mr. Phillips provided a performance update for the quarter ending December 31, 2013, and stated that all asset classes produced positive results for the period, with equity based markets outperforming the emerging market debt and fixed income markets. Mr. Phillips also discussed long term plan performance from 2003 through December 31, 2013. Mr. Phillips reviewed fiscal year-to-date performance by asset class, asset class performance versus policy benchmarks, and discussed the rankings of highest and lowest contributors to the performance within the public and private market categories. Mr. Phillips concluded his discussion by reviewing the Overlay portfolio exposure by asset class.

Mr. Brady O'Connell from Hewitt EnnisKnupp, Inc. ("HEK"), provided additional quarterly performance highlights. Mr. O'Connell concluded his performance update by reviewing trailing period performance, and total plan risk return as of December 31, 2013, in relation to the Statement of Investment Objectives and Policies ("SIOP").

Mr. Phillips turned the discussion to risk based rebalancing, and presented current initiatives completed by investment staff detailing a philosophical basis and practical implementation of risk management for the Plan. After suggesting context and caveats for the framework, Mr. Phillips reviewed definitions and outlined the requirements for practical application to the Plan. Mr. Phillips explained that one goal of this project is to use the Commission's allocation policy to create boundaries around the expected behavior and then use these models to help identify deviation from the long-term assumptions to help manage various types of risk. Mr. Phillips then detailed the expected return, the range of outcomes, and the differences in short term versus long term ranges. Mr. Phillips stated that the rolling five year, cumulative zero percent return was selected as the point from which a risk limit will be calculated. A hypothetical historical tracking chart was presented as an example, and actual, current analytical values were also presented and discussed. Screenshots of spreadsheet tools were highlighted as work samples.

Mr. Phillips stated that the risk framework was applied to the portfolio rebalance methodology. Mr. Phillips reported that several methodologies were reviewed by Staff, concluding with the current approach as "best practice." The triggers for a rebalance decision were presented, as well as the process within which the decisions are made. Mr. Phillips expanded upon the "active tilt" Plan positioning, and detailed the Tilt Tool spreadsheet with a hypothetical example. Incremental components of Plan returns were also identified via the Tilt Tool spreadsheet. Mr. Phillips concluded his presentation by providing a brief summary of current and in-process initiatives by Staff and discussing the need for a risk management system to assist with the implementation of the risk management program.

Mr. Geoff Berg, Internal Asset Management Managing Director, provided manager updates and recommendations for five contract renewals in core fixed income and high yield managers. Mr. Berg advised the Commission that the core fixed income managers include Pacific Investment Management Company ("PIMCO"), Blackrock Financial Management Inc. ("BlackRock"), and Jamison, Eaton & Wood ("Jamison"). Mr. Berg explained that core fixed income is the term used to describe a strategy that generally invests in domestic investment grade, high quality fixed income securities such as treasuries, government related issues, and corporate bonds. Mr. Berg provided investment strategy and risk control information regarding PIMCO, BlackRock, and Jamison, and stated that all three core fixed income managers have outperformed their benchmarks. Mr. Berg also noted that Jamison had agreed to reduce fees from 15 basis points

to ten basis points, and that the Commission had a most favored nation clause for fees with PIMCO and BlackRock.

Mr. Gillespie made a motion, which was seconded by Dr. Wilder and passed unanimously, to:

- I. As to the Pacific Investment Management Company:
  - a. Adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Recommendation Regarding PIMCO in a memo dated March 13, 2014;
  - b. Authorize the renewal of the Commission's existing contract with PIMCO for another term of up to five years; and
  - c. Authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the renewal of the Investment as approved by the Commission upon documented approval for legal sufficiency by RSIC Legal Counsel, and approve the waiver of the review period which was adopted by the Commission on July 19, 2012.
- II. As to Blackrock Financial Management Inc.:
  - a. Adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Recommendation Regarding BlackRock in a memo dated March 13, 2014;
  - b. Authorize the renewal of the Retirement System trust funds' existing contracts with BlackRock for another term of up to five years; and
  - c. Authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the renewal of the Investment as approved by the Commission upon documented approval for legal sufficiency by RSIC Legal Counsel, and upon expiration of the review period, as adopted by the Commission on July 19, 2012 (or as the review period may be amended or superseded by the Commission).
- III. As to Jamison, Eaton & Wood:
  - a. Adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Recommendation Regarding Jamison in a memo dated March 13, 2014;
  - b. Authorize the renewal of the Commission's existing contracts with Jamison for another term of up to five years; and
  - c. Authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the renewal of the Investment as approved by the Commission upon documented approval for legal sufficiency by RSIC Legal Counsel, and upon expiration of the review period, as adopted by the Commission on July 19, 2012 (or as the review period may be amended or superseded by the Commission).

Mr. Berg also provided an investment update and management recommendations regarding two high yield managers including PENN Capital Management ("PENN"), and Post Advisory Group ("Post"). Mr. Berg stated that the objective of a high yield strategy is to generate excess returns through tactical allocation of capital toward the best risk-return opportunities. Mr. Berg reported that Staff recommends retaining both PENN and Post as high yield managers. He also noted that both managers have agreed to a fee reduction of five basis points in the new contracts.

Mr. Gillespie made a motion, which was seconded by Dr. Wilder and passed unanimously to:



I. As to PENN Capital Management:

- a. Adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Recommendation Regarding High Yield Fixed Income Manager PENN in a memo dated March 13, 2014;
- b. Authorize the renewal of the Commission's existing contract with PENN for another term of up to five years; and
- c. Authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the renewal of the Investment as approved by the Commission upon documented approval for legal sufficiency by RSIC Legal Counsel, and approve the waiver of the review period which was adopted by the Commission on July 19, 2012.

II. As to Post Advisory Group:

- a. Adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Recommendation Regarding High Yield Fixed Income Manager Post in a memo dated March 13, 2014;
- b. Authorize the renewal of the Commission's existing contract with Post for another term of up to five years; and
- c. Authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the renewal of the Investment as approved by the Commission upon documented approval for legal sufficiency by RSIC Legal Counsel, and upon expiration of the review period, as adopted by the Commission on July 19, 2012 (or as the review period may be amended or superseded by the Commission).

Chairman Williams welcomed Ms. Suzanne Bernard from HEK to provide an asset liability review. Ms. Bernard stated that HEK conducted a detailed asset liability modeling ("ALM") review for the Commission in 2013, and noted that this year's review focused on the current allocation. Ms. Bernard introduced her colleague, Mr. Phil Kivarkis, to the Commission. Mr. Kivarkis stated that an asset liability study is intended to reflect forward looking projections on the Plan's funding ratio, contribution rates, and distributions. Mr. Kivarkis also discussed the capital market assumptions that were used in the asset liability study update, and reported on the current funding results as of June 30, 2013. Mr. Kivarkis stated that the Plan is 56 percent funded on a market value basis, and 63 percent funded on an actuarial basis, and pointed out that the actuarial value of assets is greater than the market value of assets because it reflects smoothing of asset losses in recent years. Mr. Kivarkis reported on capital market expectations for the 10 and 30 year periods, reviewed projected funding rates, and stated that HEK projects that the funding rate will increase from 19 percent covered payroll to 23 percent covered payroll. Mr. Kivarkis reported that HEK expects the Plan to exceed the seven and one half percent return on assets over the long-term. Mr. Kivarkis concluded his presentation by discussing current and proposed asset allocation strategies.

Ms. Bernard continued the asset allocation discussion by reiterated key points made by Mr. Kivarkis. Ms. Bernard commented on the importance of having diversified sources of return, and how different asset mixes perform in different market environments. Ms. Bernard stated that an important form of risk management is ensuring that current asset allocations stay within the framework that has been adopted by the Commission.

Following further discussion, Chairman Williams thanked Ms. Bernard and Mr. Kivarkis for their presentations.

Chairman Williams recognized Mr. Phillips for a review of the proposed AIP for Fiscal Year 2014-2015. Mr. Phillips noted that the AIP must be submitted to the Commission no later than April 1, 2014, and adopted by the Commission no later than May 1, 2014. Mr. Phillips stated that the proposed AIP clarifies and expands the investment consultant involvement and the strategic partnership investments. Mr. Phillips also reported that currently, there are no recommendations to change the asset allocation policy. Approval of the AIP will be sought at the Commission's May 1, 2014 meeting.

#### **IV. COO'S REPORT**

Chairman Williams recognized Mr. W. Greg Ryberg, Chief Operating Officer ("COO"), for the COO's report. Mr. Ryberg stated that he wanted to reaffirm his positive comments regarding Staff, and noted that he is proud to have the opportunity to work with such a high quality group of professionals.

Mr. Ryberg updated the Commission on an item carried over from the November meeting. He noted that the Commission had asked for information regarding iPad distributions by Mr. Loftis, and specifically from whom those iPads were obtained. Mr. Ryberg reported that he learned through media sources that the iPads were purchased by Columbia Management which manages the money in the 529 Scholarship Plan. Mr. Ryberg confirmed that the Commission does not conduct business with Columbia Management, so a fiduciary breach did not occur. Mr. Ryberg added that Columbia Management did not produce favorable returns compared to similar 529 plans.

Mr. Ryberg provided details and background information regarding the settlement with the Bank of New York Mellon ("BNYM") that was recently revealed as a result of hearings conducted by the Senate Special Subcommittee to Review the Investment of State Retirement Funds. Mr. Ryberg stated that although the BNYM settlement provided \$20 million to be returned to the Fund, this amount is insignificant compared to the \$200 million in initial losses to the Fund. Mr. Ryberg stated that settlement was only advantageous to BNYM, and the attorneys who earned \$9 million to represent the State of South Carolina. Mr. Ryberg walked the Commission through the settlement process from inception, starting with how the BNYM was chosen to be the State's custodian and securities lending agent, to the final negotiation terms. Mr. Ryberg concluded by saying that the Commission, as fiduciaries, should be apprised of the events that took place before, during, and after the settlement, and should use this knowledge to explore options available as fiduciaries of the Fund.

#### **V. AUDIT COMMITTEE REPORT**

Mr. Gillespie stated that the Audit Committee met and received completed audit reports including: consulting reports which encompassed management fees and expenses; compliance reports; and an incentive compensation calculation review. Mr. Gillespie reported that the contract compliance report is in progress along with various audits and ongoing evaluations of investments. Mr. Gillespie advised that the Audit Committee had posted a draft Code of Ethics Acknowledgement for Commissioners, similar to the Code of Ethics Acknowledgement that each Staff member has signed. Mr. Gillespie stated that once comments have been received, a final document will be presented to the Commission for review and approval.

Mr. Gillespie stated that the Audit Committee is recommending the establishment of an enterprise risk management function. Mr. Gillespie reported that the enterprise risk management function



will require (i) bifurcation of the internal audit function and the compliance function and (ii) convergence of the enterprise risk management and compliance functions, and will lead to a change in management in the internal audit function effective July 1, 2014. Mr. Gillespie also reported that the Audit Committee recommends the following changes to current job titles:

1. The Director of Audit and Compliance will become the Director of Enterprise Risk Management and Compliance; and
2. The Audit and Compliance Officer will become the Chief Audit Officer.

Mr. Andrew Chernick, Director of Audit and Compliance, provided clarification that enterprise risk management differs from investment risk management by taking a more holistic, broader view of risk including investment and accounting risk.

Following further discussion, Mr. Gillespie made a motion on behalf of the Audit Committee that the Commission adopt the recommendations set forth in the report presented by the Chairman of the Audit Committee to:

1. Approve the establishment of an Enterprise Risk Management function with operational reporting responsibility to the Audit Committee effective July 1, 2014;
2. Approve (a) the bifurcation of the Internal Audit and Compliance function effective April 1, 2014 and (b) the convergence of the Enterprise Risk Management and Compliance functions effective July 1, 2014;
3. Approve the following changes to job titles for the current positions effective April 1, 2014:
  - A. The Director of Audit and Compliance will become the Director of Enterprise Risk Management and Compliance; and
  - B. The Audit and Compliance Officer will become the Chief Audit Officer.
4. Authorize the Audit Committee Chairman or his designee to (a) revise job descriptions and (b) execute any necessary documents to implement the foregoing changes consistent with the actions taken by the Commission; and
5. Authorize Staff to make any technical revisions or formatting edits to the Audit Committee Charter and the Commission's Governance Policies consistent with the foregoing actions taken by the Commission.

The motion was adopted unanimously.

## **VI. COMPENSATION COMMITTEE REPORT**

Mr. Giobbe presented a report regarding the Compensation Committee's March 2014 meeting. Mr. Giobbe noted that the Committee was proposing several technical revisions to the Commission's Compensation Committee Charter ("Charter"), changing the number of Commission members to seven, separating the CIO and CEO titles, and altering the Compensation Committee's composition to three Commissioners. Mr. Giobbe also noted that the Committee was proposing technical revisions to the Commission's Compensation Policy changing the title of Director of Operations to Chief Operating Officer.

Mr. Giobbe made a motion on behalf of the Compensation Committee that the Commission adopt the recommendations set forth in the report presented by the Chairman of the Compensation Committee to:

1. Approve the revisions to the Compensation Committee Charter referenced above;
2. Approve the recommended changes to the Compensation Policy; and
3. Authorize Staff to make any technical revisions or formatting edits to the Compensation Committee Charter, the Compensation Policy, and/or the Commission's Governance Policies consistent with the foregoing actions taken by the Commission.

The motion was approved by a vote of 5-1, with Chairman Williams, Mr. Giobbe, Mr. Gillespie, Dr. Gunnlaugsson, and Dr. Wilder voting for the motion, and Mr. Loftis voting against the motion.

Mr. Loftis commented that he did not vote in favor of the recommended changes to the Compensation Policy because "he is repeatedly punished for trying to support the employees by voting for these raises, but he has problems with the benchmarks".

## **VII. STRATEGIC PLAN**

Ms. Bernard reported that Staff had identified 14 strategic plan initiatives based on existing priorities and feedback from Commissioners over the past year. Ms. Bernard stated that the implementation of an investment risk system was the number one initiative identified by the Commissioners, closely followed by expanding infrastructure for improving monitoring of, and gathering position-level data from, external managers, enhancing the middle and back office systems, and supporting internally managed portfolios.

Ms. Corbett discussed the operational initiatives including:

1. Operational infrastructure development;
2. Fully migrating to quarterly reporting of investment management fees;
3. Consider development of a new fee reporting format to capture recoupment of management fees and other expenses;
4. Development and implementation of a Business Continuity Plan; and
5. Completion of an IT self-assessment.

Chairman Williams thanked Ms. Bernard and Ms. Corbett for their strategic plan reports.

## **VIII. EXECUTIVE SESSION**

Mr. Giobbe made a motion which was seconded by Mr. Gillespie and passed unanimously, to recede to executive session to discuss personnel matters, receive legal advice and briefings, and discuss investment matters pursuant to S.C. Code Ann. §§30-4-70 (a) (1)-(2), 9-16-80 and 9-16-320.

Chairman Williams announced that the Commission would meet in executive session for the purpose to discuss personnel matters, receive legal advice and briefings, and discuss investment matters. The Commission thereupon receded into executive session.

The Commission reconvened in open session. It was noted that Chairman Williams and Dr. Gunnlaugsson had left the meeting towards the end of executive session, and that Mr. Giobbe had assumed the role of acting Chairman. Mr. Giobbe reported that no action had been taken in executive session, and no action needed to be taken as a result of executive session.

**IX. ADJOURNMENT**

There being no further business and upon motion from Mr. Gillespie, which was seconded by Dr. Wilder and passed unanimously, the meeting adjourned at 5:30 p.m.

[Staff Note: In compliance with S.C. Code Ann. §30-4-80, public notice of and the agenda for this meeting were delivered to the press and to parties who requested notice and were posted at the entrance, in the lobbies, and near the 15<sup>th</sup> Floor Conference Room at 1201 Main Street, Columbia, SC, at 3:14 p.m. on March 11, 2014.]

# Securities Lending: Overview And New Manager Recommendation

Geoff Berg, CFA, Managing Director

Nicole Waites, Investment Analyst

Scott Forrest, Operational Due Diligence Officer



# Purpose

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- Staff proposing a change to Securities Lending program
  - Additional layers of protection against program losses
  - Improved economics from lending
  - Improved yield on reinvested collateral
  - Improved transparency and reporting
- Recommending that the Commission hire Deutsche Bank as a third-party securities lending provider
  - STO's custody contract anticipated the use of third-party lenders at an annual cost of \$75,000



# Securities Lending – *What Is It?*

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- Two transactions – Lending and Collateral Reinvestment
- An investment entity may lend its securities in exchange for an expected financial gain
  - Most commonly, the borrower collateralizes the loan with cash, that the investor will reinvest.
  - There is an agreement of a *rebate rate* that establishes the economic “cost” of the transaction.
    - *Positive* rebate rate = Lender pays the borrower
    - *Negative* rebate rate = Borrower pays the lender
- Title for the securities is conveyed to the borrower
  - Lender relinquishes the right to vote the shares that are loaned
  - Borrower must provide cash flows to lender that reflect dividends and interest payments



# Securities Lending - Key Risks

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- Potential problems with the Lending Transaction
  - Counterparty does not maintain sufficient collateral
- Potential problems with the investment of the collateral
  - Credit risk – losses related to an impairment of the investment due to an entity's inability or unwillingness to repay a debt
  - Interest rate risk – losses that result from a sharp change in short-term interest rates



# Basis For Recommendation

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- Layers of protection against program losses
- Improved economics from lending
- Improved yield from reinvestment of collateral
- Improved transparency and reporting



# Layers of Protection

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- Double Indemnification
  - Protection against the insolvency of the borrower of a security
  - Protection against a repo counterparty's insolvency
- DB's program has experienced none of the catastrophic losses and litigation associated with other programs

*Our program remains healthy having successfully navigated the global downturn without catastrophic losses, negative press or withdrawal restrictions. Our program has never been the subject of litigation, threatened litigation, regulatory investigation or supervisory action. These are a telling reflection of our conservative philosophy, risk management process and seasoned management team.*

- DB acts as a fiduciary for both the Lending and the Collateral Reinvestment Transactions



# Improved Economics From Lending

- Staff evaluated lending data to better gauge potential benefit of a “specialist” lender

	Utilization Rates		Rebate Rates		Lending Income (Monthly)	
	BNYM	DB	BNYM	DB	BNYM	DB
<b>Best 10 Rebates</b>	95.7%	93.4%	-6.0%	-10.1%	107,753	175,790
<b>Best 25 Rebates</b>	65.7%	61.6%	-4.9%	-8.2%	117,673	182,944
<b>Best 100 Rebates</b>	33.0%	55.5%	-1.3%	-1.1%	154,049	211,125

*Utilization and Rebate Rates for the month ending January 31, 2014*

*Securities ranked in order of rebate rate earned by BNY Mellon for January 2014, as reported*

- Data strongly suggests opportunity for improving the economics from lending activities



# Improved Reinvestment Yield

- Indemnification provisions create a “beneficial chain reaction”
  - DB absorbs key risk of repo transactions (counterparty insolvency)
  - Indemnification allows diversified collateral types and terms
  - Interest rate risk unaffected by indemnification
  - Higher yields with reduced risk encourages greater utilization

Indemnified Repo Rates (return over Fed Funds)

		Term			
Collateral Allocation		Open and O/N	33 Days	63 Days	93 Days
Collateral Type	Treasury/Agency/Agency MBS	2	3	4	5
	Money Markets	8	15	20	25
	Investment Grade Corporates (≥ BBB-)	15	20	35	40
	Investment Grade Municipals (≥ BBB-)	15	20	30	45
	ABS (AAA)	–	45	55	65
	US Equity	20	35	40	45
Fed Funds Open		0.08%			

# Improved Transparency and Reporting

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- Real-time transparency vs. lagged reporting
- Independent benchmark data
- Robust and customizable client reporting capabilities
  - Dashboard snapshots
  - Counterparty exposures
  - Historical rebate rate data
  - Compliance dashboard
- Email distribution of reports





# Summary

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- Additional layers of protection against program losses
  - Improved economics from lending
  - Improved yield from reinvestment of collateral
  - Improved transparency and reporting
- 
- Questions?



SOUTH CAROLINA  
RETIREMENT SYSTEM  
INVESTMENT  
COMMISSION

DUE DILIGENCE  
REPORT

*Deutsche Bank  
Securities Lending*

SC Due Diligence Team	Investment
Geoffrey Berg, CFA, Managing Director Nicole Waites, Investment Analyst Scott Forrest, Operational Due Diligence Officer	Deutsche Bank Securities Lending Program

Summary Terms Chart:		Source
<b>Fund Name:</b>	(Deutsche Bank Securities Lending Agreement)	N/A
<b>Maximum Investment Amount:</b>	N/A	N/A
<b>Management Fee:</b>	N/A	N/A
<b>Performance Fee/Carried Interest:</b>	10% of the monthly Realized Income of the program.	Draft contract, page 9
<b>Hurdle Rate/Preferred Return:</b>	N/A	N/A
<b>Target Investment Period:</b>	N/A	N/A

<b>Investment Recommendation</b>	<p>RSIC Staff is recommending a structural change in the SCRS trust funds' Securities Lending program. Specifically, the Research Team ("Team") is recommending the use of Deutsche Bank as both a third-party Lending Agent as well as the manager of the collateral reinvestment pool. The Team anticipates several major benefits from such a change, including:</p> <ol style="list-style-type: none"> <li>1) Improved economics from lending securities,</li> <li>2) Improved yield on reinvested collateral,</li> <li>3) Additional layers of protection against program losses,</li> <li>4) Improved program reporting and transparency.</li> </ol>
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<b>Strategy Description</b>	<p><b>DB's Lending Philosophy</b></p> <p>DB's lending approach focuses on "specials" (specials are securities that have an intrinsic spread of at least 25bps) that will provide the highest intrinsic spread, while operating within the risk parameters set with each client. When deciding which borrowers to lend to, DB focuses on the "end-users" of securities – prime brokers, primary dealers and derivatives specialists – as these firms originate demand and are the most profitable and safest firms to lend to. DB segregates each special from its supply and obtains indications of interest from the end-users and then allocates the special to the firm that is willing to accept the most profitable rebate rate for DB's securities lending clients. DB also actively manages existing loans by using vendor data and analytics to determine if "re-rating" of the loan is advantageous. To reduce the counterparty risk for the client, DB is obligated to provide identical replacement securities in the event of a borrower insolvency, even if the collateral is insufficient to do so due to an increase in market value. Borrow indemnification is common practice in securities lending programs.</p> <p><b>DB's Indemnified Repurchase Agreements ("Repo")</b></p> <p>In conjunction to borrower indemnification, DB also offers indemnification on repo in the cash collateral reinvestment pool. In the event of insolvency by a repo counterparty, DB indemnifies</p>
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the client with respect to any shortfall between liquidation proceeds of securities collateral received from the counterparty and the amount of cash invested. In the event of a shortfall, DB's obligation is to restore the amount of cash that was invested with the counterparty. The indemnification extends to overnight and term repo, as well as traditional and non-traditional collateral types.

In order to reduce the risk of indemnified repo, DB relies on its Risk Division, which has a staff of 4,200 globally that has independent oversight of bank-wide risk, trading and investment activities. Within the Risk Division, DB has a centralized Credit Risk Management (CRM) function that screens and establishes formal credit limits for each counterparty. The Risk Division approves permissible collateral types and adjusts as deemed prudent. Repos are diversified across dealers, collateral types, and clients to prevent undue concentration and liquidity risk. Also the majority of repos are executed with overnight maturities (currently 70%).

Programs in which the Lending Agent also manages the investments in the collateral reinvestment pool have rarely been able to structure the compensation arrangement in such a way as to avoid the inherent agency conflict. In most cases, the Lending Agent is rewarded for taking more risk in the Collateral Reinvestment Transaction – as in Scenario B above – since it is more profitable for his firm if he purchases riskier securities for clients. When the whole proposition ends badly, however, ***only the investor experiences the losses***. In recognition of this risk imbalance, many investors have elected to restrict the risks allowed in their Securities Lending programs. With respect to the lending transaction, under the Agreement, DB is obligated to step in and make their clients whole in the event of borrower insolvency ("borrower indemnification"). Whereas industry practice calls for clients to bear all aspects of Collateral Reinvestment risk, DB also offers indemnification against counterparty insolvency related to investments of cash collateral in Repo transactions ("indemnified repo").

Indemnification against losses related to the Collateral Reinvestment Transaction reduces the potential for the misalignment of incentives that can lead to the risk seeking behavior outlined above. When the Lending Agent manages the collateral reinvestment pool and is compensated on the combined economics that flow from both transactions (Lending *plus* Collateral Reinvestment), the presence of the indemnification provision shifts the risk of loss from the Investor to the Agent.

#### **IMPACT OF INDEMNIFICATION ON REPURCHASE AGREEMENT ("REPO") INVESTMENTS**

At the present time, the RSIC's Securities Lending program is restricted in two ways. First, BNY Mellon is permitted to invest in overnight repo transactions. Second, these repo transactions are being limited to the highest quality collateral (US Treasury and Agency securities). These repo transactions have several structural layers of risk mitigation. First, they are over-collateralized by the counterparty, with the degree of over-collateralization dependent upon the type of collateral involved. Second, the repo seller has a legal obligation to continue to maintain the proper amount of collateral, and to the extent that it wishes to avoid defaulting on its obligations, its creditworthiness further reduces the risk to the RSIC. Third, these transactions are implemented in a "tri-party" framework, which means that an agent (the "tri-party agent") administers the transaction between the two parties to the repo transaction.

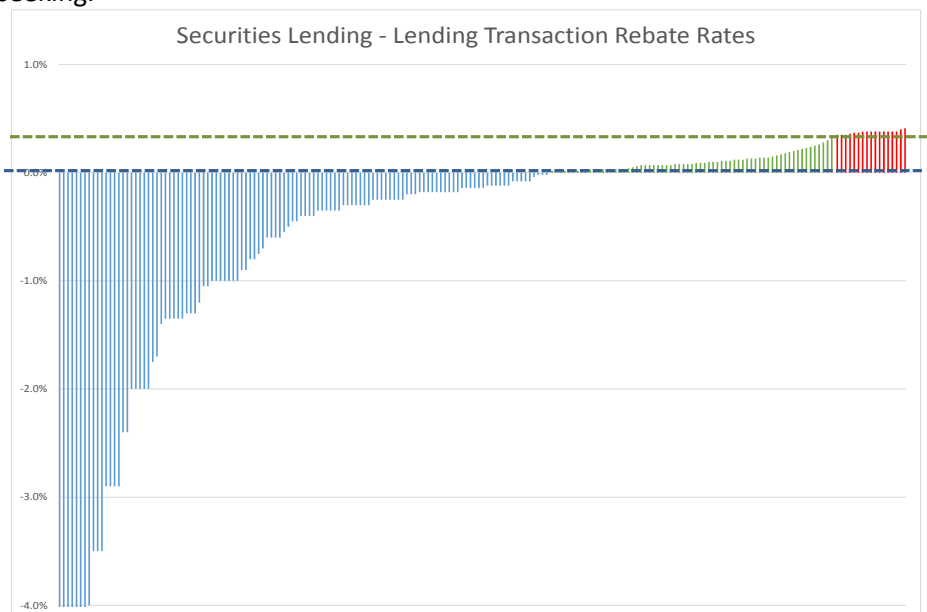
While rebate rates and utilization do matter, the full picture comes into focus only when we understand the impact of the indemnification provisions offered by DB. It is critical to appreciate the degree to which these additional layers of credit risk protection are important.

The presence of the dual indemnification provisions creates a beneficial chain reaction. With DB absorbing the credit risk in the Collateral Reinvestment Transaction, the RSIC can target a higher rate of return (compared to the current state). This improvement then begets additional lending activity, thus raising the Portfolio Utilization Rate (PUR). What does this mean?

The chart below helps to demonstrate the link between the Collateral Reinvestment Rate of Return and the PUR. Recall that the *Rebate Rate* represents a rate of return that is credited to the borrower during the period of time that the lender is in possession of the borrower's cash collateral. It does not make economic sense to lend securities that have a rebate rate that entirely consumes the expected return on cash collateral.

With respect to the chart below, let us assume that Investor A's Securities Lending program reinvests its collateral to earn 0.05% while Investor B's does so to earn 0.30%. These income levels are represented by the dotted lines and establish a threshold for profitable lending for each investor. The bars in the chart reflect the hypothetical rebate rates for each individual security. For both Investor A and Investor B, the securities represented by the blue bars create a profit when loaned, because they fall below both investor's Collateral Reinvestment return lines. (Recall the convention for quoting rebate rates: *negative rebate rates create net income to the investor (lender).*) The green bars represent securities with rebate rates that will more than offset Investor A's Collateral Reinvestment return. Investor B, however, will still benefit from loaning these securities, because he is earning 0.30%, but paying (or rebating) less than this amount to the borrower. Loaning the securities with higher rebate rates (signified by the red bars) does not benefit either investor.

Against the backdrop of an earlier point, it may seem as though Investor B is engaging in unprofitable lending. The key distinction in this scenario is that Investor B is earning a higher yield through the benefit of the indemnification provision, as opposed to earning a higher yield through sheer risk seeking.



**Background  
Information:**

Firm Name:

Deutsche Bank, AG

	Diligence Contact:	Joseph Santoro
	SC Target Closing Date:	Summer/Fall 2014
	Final Closing Date:	N/A
	Advisory Board Seat:	N/A
	Geographic Focus:	N/A

<b>Key Investment Rationale</b>	<ol style="list-style-type: none"> <li>1. Improved economics from lending securities,</li> <li>2. Improved yield on reinvested collateral,</li> <li>3. Additional layers of protection against program losses,</li> <li>4. Improved program reporting and transparency.</li> </ol>
<b>Investment Considerations</b>	Complexity relating to the existing Securities Lending relationship, Need to notify investment managers of third-party lending relationship, Potential changes to DB's creditworthiness affect the quality/strength of the indemnification.
<b>Portfolio and Asset Class Plan Fit</b>	N/A

### Firm History and Overview

<b>Firm Overview</b>	<p>Deutsche Bank, AG (“DB”) was founded in 1870 and is a leading global universal bank that operates as a banking company with limited liability incorporated under the laws of Germany. DB’s businesses encompass a wide range of products spanning investment, corporate, retail banking and asset/wealth management. DB has 98,219 employees in 72 countries and 2,984 branches, with approximately 11,000 employees in the United States.</p> <p>DB is divided in four organizational divisions: Corporate Banking and Securities, Global Transaction Banking, Asset &amp; Wealth Management, and Private &amp; Business Clients. The Agency Securities Lending (“ASL”) Group falls within the Global Transaction Banking division. The ASL program operates from offices in New York, London, Frankfurt and Hong Kong. The contractual entity providing agency securities lending services to US clients is Deutsche Bank, AG, New York Branch. DB’s activities in the US are regulated by the Federal Reserve Bank and New York State Banking Department.</p> <p>DB is currently rated by all the leading credit agencies. The credit rating is an assessment of the financial strength of a firm. DB is rated as follows:</p> <table><tr><th>Issuer</th><th>Moody's</th><th>Outlook</th><th>Fitch</th><th>Outlook</th><th>S&amp;P</th><th>Outlook</th></tr><tr><td>Deutsche Bank</td><td>A2</td><td>NEG</td><td>A+</td><td>NEG</td><td>A</td><td>STABLE</td></tr></table>	Issuer	Moody's	Outlook	Fitch	Outlook	S&P	Outlook	Deutsche Bank	A2	NEG	A+	NEG	A	STABLE
Issuer	Moody's	Outlook	Fitch	Outlook	S&P	Outlook									
Deutsche Bank	A2	NEG	A+	NEG	A	STABLE									
<b>Ownership and Personnel Compensation</b>	<b>Public company (NYSE: DB)</b>														
<b>Key Personnel</b>	<ul style="list-style-type: none"><li><b>Joseph Santoro</b> is the Head of US Origination. Joe has been with the team since 2003 and possesses more than 28 years of broad experience in the securities lending industry across marketing, product, legal, tax and regulatory matters. Before this, Joe was a Senior Vice President in charge of Marketing with Metropolitan West Securities LLC. Prior to that, Joe</li></ul>														



	<p>was a Director in the Equity Finance Group at Credit Suisse for four years, where he was responsible for sales of principal and agent securities lending services. Joe spent the first 16 years of his career with Chase Manhattan Bank where he was Chief Marketing Officer and Product Manager for their program. Joe completed the Bank's management training program. He received his Bachelor of Science Degree from Rider University. He holds NASD Series 7 and Series 63 licenses.</p> <ul style="list-style-type: none"> <li>• <b>Anthony Toscano</b> is Co-Head of Agency Lending in New York and Head of U.S. Trading. He has been part of the core management team since 1997 and is currently responsible for all aspects of risk management, trading, and product development. Anthony also interfaces with the FRB and industry groups such as the RMA on regulatory matters. Anthony has over 20 years of securities finance experience from both agent to principal perspectives as well as custodial and non-custodial perspectives having held senior positions with Allianz Group and JP Morgan. Anthony received a Bachelor of Arts degree from Seton Hall University and a Masters in Business Administration from the W. Paul Stillman School of Business at Seton Hall University.</li> <li>• <b>Frank Gambino</b> is Co-Head of Agency Lending in New York and the Head of Product Management &amp; Client Service. He has been part of the core management team since 1997. Frank has over 20 years of securities finance experience from both agent to principal perspectives as well as custodial and non-custodial perspectives, with particular emphasis on global operations &amp; processing, settlements, compliance, audits, technology and reporting. Frank also interfaces with the FRB and industry groups such as the RMA on regulatory matters. Prior to Deutsche Bank, Frank was Head of Operations for Lehman Brothers Trust Company. Prior to Lehman, Frank was Head of Operations for Securities Lending and Cash Management at J.P. Morgan (Morgan Guaranty). Frank began his career in a variety of different securities processing and cash management roles at J.P. Morgan.</li> <li>• <b>Tim Smollen</b> is the Global Head of Deutsche Bank's Agency Securities Lending Program. As Global Head, he oversees 65 employees and all aspects of the business across six locations including NY, London, Frankfurt and Hong Kong. Additionally, Tim is a member of Deutsche Bank's Direct Securities Services Executive Committee which is responsible for setting organizational objectives within the Global Transaction Banking (GTB) Division. Tim has over 20 years of securities lending experience which includes running both custodial and 3rd party lending platforms in both global markets and securities services organizations, including Allianz Group and JP Morgan. Tim holds a Bachelor of Science Degree from Fordham University, NY.</li> <li>• <b>Amy Dunn</b> manages Client Service for Americas clients. Amy has been with the ASL team since 2005. Prior to this, Amy spent 5 years at Allianz Dresdner Asset Management as a client service/business development manager. She has extensive experience in the RFP process, customizing reporting and providing proactive client service. Amy received a Bachelor of Arts degree in Economics &amp; Business from Lafayette College and holds NASD Series 7 and 63 licenses.</li> </ul>
Succession Plans	N/A

<b>Employee Turnover</b>	None in last two years among ASL program. Seven members of the management team have been working together for 20 years (according to DB, this makes them the “longest tenured management team in the industry.”)																																			
<b>Products Managed, Assets Under Management (“AUM”), and Investor Base</b>	<p>Sample list of US Public Pension Funds and State Treasurers:</p> <p>Connecticut Retirement Plans &amp; Trust Funds (\$26.1B) – exited State Street’s program</p> <p>SURS of Illinois (\$16B) – exited Credit Suisse’s program</p> <p>Kentucky Retirement System (\$14B) – exited Northern Trust’s program</p> <p>Kentucky Workers’ Comp (\$2.5B) – first time lender</p> <p>Texas Municipal Retirement System (\$19.5B) – exited State Street’s program</p> <p>Tennessee Consolidated Retirement System (\$34B)</p> <p>State of Iowa (STO and IPERS, \$29B combined) – exiting BNY Mellon’s program (BNYM is custodian)</p> <p>Chicago Teachers Pension Fund (\$9.5B) – exited Northern Trust’s program</p> <p>LRBEABF of Chicago (\$1.4B) – exited Northern Trust’s program</p> <p>Policemen’s Annuity and Benefit Fund of Chicago (\$3.2B) – exited Northern Trust’s program</p> <p>FPPA of Colorado (\$3.2B) – exited BNY Mellon’s program (BNYM is custodian)</p> <table><tr><th></th><th>Clients Gained (Number)</th><th>Clients Gained (US\$ millions)</th><th>Clients Lost (Number)</th><th>Clients Lost (US\$ millions)</th></tr><tr><td>2008</td><td>4</td><td></td><td>4</td><td></td></tr><tr><td>2009</td><td>4</td><td></td><td>2</td><td></td></tr><tr><td>2010</td><td>3</td><td></td><td>1</td><td></td></tr><tr><td>2011</td><td>4</td><td></td><td>0</td><td></td></tr><tr><td>2012</td><td>5</td><td></td><td>0</td><td></td></tr><tr><td>2013 (thru 6/30)</td><td>5</td><td></td><td>0</td><td></td></tr></table>		Clients Gained (Number)	Clients Gained (US\$ millions)	Clients Lost (Number)	Clients Lost (US\$ millions)	2008	4		4		2009	4		2		2010	3		1		2011	4		0		2012	5		0		2013 (thru 6/30)	5		0	
	Clients Gained (Number)	Clients Gained (US\$ millions)	Clients Lost (Number)	Clients Lost (US\$ millions)																																
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2009	4		2																																	
2010	3		1																																	
2011	4		0																																	
2012	5		0																																	
2013 (thru 6/30)	5		0																																	

### Investment Analysis

Market Overview	N/A																																			
Performance and Risk Analytics	<p><i>The following performance analysis is taken from the Team’s memo, and it compares the income generated from lending activities by DB to BNY Mellon:</i></p> <p>The different rebate rates speak to the different business models. BNY Mellon appears to have a more “generalist” approach to lending, whereas DB has a “specialist lender” approach. These approaches differ in that specialist lenders try to focus on lending a smaller number of positions that are highly profitable (“specials”), as opposed to lending a significant amount of a client’s assets at relatively low levels of profitability.</p> <p>Consistent with their different approaches, DB was found to have achieved significantly better rebate rates on the specials than BNY Mellon. This is most noticeable among the Best 10 rebates in the table below. Their specialist approach also yields a greater concentration of lending income in the Best 10 securities.</p> <table><tr><th></th><th colspan="2">Utilization Rates</th><th colspan="2">Rebate Rates</th><th colspan="2">Lending Income (Monthly)</th></tr><tr><th></th><th>BNYM</th><th>DB</th><th>BNYM</th><th>DB</th><th>BNYM</th><th>DB</th></tr><tr><td><b>Best 10 Rebates</b></td><td>95.7%</td><td>93.4%</td><td>-6.0%</td><td>-10.1%</td><td>107,753</td><td>175,790</td></tr><tr><td><b>Best 25 Rebates</b></td><td>65.7%</td><td>61.6%</td><td>-4.9%</td><td>-8.2%</td><td>117,673</td><td>182,944</td></tr><tr><td><b>Best 100 Rebates</b></td><td>33.0%</td><td>55.5%</td><td>-1.3%</td><td>-1.1%</td><td>154,049</td><td>211,125</td></tr></table> <p><i>Utilization and Rebate Rates for the month ending January 31, 2014</i></p> <p><i>Securities ranked in order of rebate rate earned by BNY Mellon for January 2014, as reported</i></p>		Utilization Rates		Rebate Rates		Lending Income (Monthly)			BNYM	DB	BNYM	DB	BNYM	DB	<b>Best 10 Rebates</b>	95.7%	93.4%	-6.0%	-10.1%	107,753	175,790	<b>Best 25 Rebates</b>	65.7%	61.6%	-4.9%	-8.2%	117,673	182,944	<b>Best 100 Rebates</b>	33.0%	55.5%	-1.3%	-1.1%	154,049	211,125
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	From material provided by Deutsche Bank on 4-3-2014: "Never in its history has our team produced negative monthly results for a client."
<b>Investment Process</b>	<p>DB's risk management teams continuously monitor the risks associated with counterparties, collateral, liquidity, regulations and actively advise the securities lending team on risk mitigation. On a daily basis, ASL's dedicated risk team (organizationally separate from ASL) analyzes the risk characteristics of the securities loaned to each particular counterparty, as well as the collateral received as repo collateral vis-à-vis the risk characteristics from each counterparty. The purpose is to proactively mitigate various risks (e.g., concentration risk, liquidation risk, correlation risk, and wrong way risk), which might be addressed via adjusting loan or repo limits/tenor, collateral types, margining, or other measures. Adjustments are made as market conditions fluctuate in order to maintain a stable risk profile which is commensurate with the clients expected returns. Regulatory changes require banks to account for their securities lending indemnifications on their balance sheets. Deutsche Bank has recognized the cost of providing such indemnifications as part of the Basel Accord while many other market participants are only now coming to grips with what the true expense is to providing such indemnifications.</p> <p>DB's trading and operating platform operates in real-time with pre and post trade compliance controls. Each client has a unique account with customized investment guidelines, which are documented in the Agency Securities Lending Agreement along with any account restrictions and operating guidelines. DB establishes repo collateral accounts for every client with each of the tri-party repo collateral custodians. They execute repo transactions at the client level pursuant to the relevant set of acceptable collateral schedules. Following trade execution, repo collateral is subsequently verified and monitored by ASL and its dedicated risk team. DB renders full transparency as to each client's collateral holdings. Also, it makes it possible for clients to access their collateral in a business contingency situation. In DB's view, the above represents the greatest level of safety and segregation possible.</p>
<b>Investment Risk Management</b>	<p>Deutsche Bank employs a leading-edge enterprise-wide risk management model. 4,169 employees are devoted to managing risk via a formal Risk Division ("Risk") that addresses the full spectrum of threats and opportunities facing Deutsche Bank. Risk strives to enhance shareholder value and protect Deutsche Bank's capital, integrity, and reputation by providing its business partners with innovative solutions. The units within the Risk Division interface with ASL on all aspects of risk. The Bank takes a conservative posture with respect to credit exposure. Credit limits, for example, are carved out of the Bank's general lines; therefore, the analytical approach in reviewing broker dealers is one and the same for the Program and the Bank. CRM uses a proprietary process to assign internal limits unique to each securities borrower and counterparty to repurchase agreements made with cash collateral (collectively referred to as "Counterparties"). Each Counterparty is subject to on-going credit monitoring and a formal annual review. Many factors are reviewed when assessing Counterparties, including but not limited to Company History/Reputation, Management, Business Type, Total Capital, Earnings, Asset Quality, Liquidity, Funding, Capitalization, Public credit ratings (if applicable), and Material Regulatory Actions (i.e., Events that constitute real or potential Additional Events of Default as set forth under the Master Securities Loan Agreement with counterparties such as regulatory revocations, suspensions, expulsions).</p> <p>Our objective is to produce a reliable stream of incremental income, month over month, regardless of interest rate conditions. We focus on intrinsic value. Many of our clients are highly regulated entities with limited guidelines (e.g., central banks, governmental entities, investment funds, insurers); therefore, mismatch at the program level is on average consistently less than five days.</p>

	<p>Reinvestment portfolios are stress tested on an ongoing basis against potential changes in interest rates. Our Risk Management Workstation (RMW) provides real-time GAP reporting showing the interest rate sensitivity of the client's account factoring in loan-side and reinvestment-side repricing dates and final maturities. Real-time GAP reporting is a standard part of the client reporting package.</p> <p>The asset and liability functions (lending and reinvestment) are integrated. When clients manage cash in-house, we ensure that trading desks are coordinated. We do not simply ship off cash collateral. We endeavor to have dialogue with the client's cash manager to coordinate on opportunities to enhance or protect returns and manage risk. The advantage in this approach is we can quickly adjust loan and/or reinvestment positions in anticipation of near-term changes.</p> <p>We place a high emphasis on liquidity. It is our responsibility as securities lending risk managers to ensure that adequate liquidity is available to accommodate returns from the Street, as well as recalls from managers (e.g., sales, proxy voting). The amount of liquidity maintained in a client's strategy is based largely on lendable asset types/mix, account size, current demand, balance volatility, turnover, and guidelines. The amount is customized at the client level, but on average, 50% or more overnight liquidity is maintained across a diverse multibillion dollar mandate with standard pension guidelines. Equity mandates often have higher liquidity due to the fact that Regulation T compels borrowers to return lent securities promptly upon the close out of the transactions that necessitated the borrowing (i.e., borrowings must meet a "purpose test"). This translates into the possibility of loans being returned without prior notice up to 3:00 pm.</p> <p>Liquidity risk is further mitigated through an integrated trading and investment function and a disciplined approach to asset and liability management. Our team continuously assesses the lending and reinvestment strategy according to the client's holdings, manager trading patterns/turnover, demand and dealer trading patterns (e.g., quarter-ends, pressure dates) and market conditions. Cash is managed on a separate account basis. Having a manageable number of clients (through selective marketing) enables us to monitor each client and proactively optimize liquidity at the client level. Our strategy with short term money entails a focus on overnight, collateralized repurchase agreements, money funds, banks products and similar vehicles.</p>
<b>Investment Guidelines</b>	<p>Lending restriction: No single borrower may account for more than 25% of the aggregate amount on loan, except when such amount totals less than 0.5% of the total Trust assets.</p> <p>Permissible repo collateral: money market instruments, US Treasury, Agency, Agency MBS, investment grade corporate securities, investment grade municipal securities, investment grade asset-backed securities, equity securities. Any other collateral type will need to be approved in advance by the CIO or his designee.</p> <p>Maturity and Duration: The weighted average duration of the Collateral Pool shall not exceed 45 days without the prior approval of the CIO or his designee. The final maturity for any repo transaction shall not exceed 93 days without the prior approval of the CIO or his designee.</p> <p>Diversification: No single repo counterparty shall account for more than 25% of the total Collateral Pool investments, except when such amount totals less than 0.5% of the total Trust assets.</p>
<b>Allowable Securities and Liquidity</b>	Deutsche Bank-managed repo transactions and cash equivalents

<b>Leverage</b>	N/A	
<b>Summary Terms</b>	Fund Structure:	Individual investments are structured as Tri-Party Repo transactions
	Capital Call Notice:	N/A
	GP Commitment:	N/A
	Organization Expense:	N/A
	GP Clawback:	N/A
	Investment Term:	Open-ended
	Key Person Clause:	N/A
	For Cause Removal:	N/A
<b>Reference Checks</b>	<p>Illinois SURS: “We’re very positive about Deutsche. We have nothing but wonderful things to say about them. Very professional.”</p> <p>Iowa State Treasurer’s Office: “Very professional, straightforward approach...”</p> <p>Connecticut Retirement Plans &amp; Trust Funds: “Our experience with DB has been positive. We chose DB in order to reduce our risk on the investment side.”</p> <p>Kentucky Retirement Systems: “We really like that DB delivers every time we have a request particularly with reporting. Customer Service is excellent.”</p>	

### Organization and Compliance

<b>Back Office Staffing &amp; Systems</b>	<p>Deutsche Bank AG is a public company. The firm is listed on the NYSE and the Deutsche Börse. Deutsche operates as a banking company with limited liability incorporated under the laws of the Federal Republic of Germany. Deutsche bank operates in 72 countries and over 2,900 branches. The bank has over 90,000 employees and approximately 11,000 employees are based in the U.S.</p> <p>There four divisions of Deutsche Bank are the following:</p> <ol style="list-style-type: none"> <li>1. Corporate Banking &amp; Securities</li> <li>2. Global Transaction Banking *</li> <li>3. Asset &amp; Wealth Management</li> <li>4. Private &amp; Business Clients</li> </ol> <p>* Agency Securities Lending resides within Global Transaction Banking</p> <p>Agency Securities Lending (“ASL”) has four global offices (New York, London, Frankfurt and Hong Kong). The ASL Team covers approximately sixty clients, which is much lower than a traditional</p>
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	<p>custodian model that has hundreds of clients. Deutsche Bank supplied the following organizational chart in Due Diligence</p>
<b>Legal and Compliance</b>	<p>In the U.S., Deutsche Bank is regulated by the Federal Reserve and the New York State Banking Department. In Germany, Deutsche Bank is regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (known as BaFin). Both U.S. regulators require permanent full-time examiners to reside at Deutsche Bank's New York office. There are approximately thirty from the Federal Reserve and five from the New York State Banking Department.</p> <p>For the onsite meeting, we met with Kenneth Hall (Director - Head of Global Transaction Banking and Regulatory Compliance). Kenneth's department oversees compliance policies and procedures that are applicable to the ASL Team and other business lines that fall under Global Transaction Banking and Bank Regulatory Compliance. Some of items that his team reviews are the following: Know-Your-Client registration rules, Anti-Money Laundering, investment guideline compliance, conflicts of interest, confidentiality with firm-level information barriers and annual compliance certification and testing.</p> <p>In regards to internal compliance, Deutsche Bank staff must comply and certify to the firm Code of Ethics on an annual basis. All personal trading transactions are subject to a dual approval for all non-exempt securities. The pre-clearance for personal trading is received from both the Business Signatory Officer ("BSO") and Compliance team at Deutsche Bank. All approved transactions are subject to a thirty day holding period. In addition, Deutsche requires their staff to use preapproved and designated brokers for all covered account holdings. In an extremely conservative approach, Deutsche even requires employee mutual fund accounts to be disclosed and housed at approve designated brokers.</p> <p>Deutsche Bank's Group Audit is part of the banks internal control organization. Deutsche highlights the following information about this group, "Group Audit provides a systematic approach to examine, evaluate and report objectively on the adequacy of both the design and effectiveness of the processes, systems, internal control environment including risk management and governance processes. Group audit operates under the authority provided by Deutsche Bank's Management Board."</p> <p>Deutsche Bank can act as a Fiduciary for public pension funds. They currently perform the role of fiduciary for pension clients that require this level of oversight. The ASL Team has approximately seventeen U.S. Public Funds and State Treasurers for clients. Examples of clients at the state level are: Florida State Board of Administration (FRS), Texas Employees Retirement System (ERS), Colorado Public Employees' Retirement (COPERA), Connecticut Retirement &amp; Trust Funds (CRPTF), Tennessee Consolidated Retirement System (TCRS) and the Kentucky Retirement System (KRS).</p> <p>One major differentiation factor with Deutsche and their security lending program is their litigation record. Deutsche Bank reported the following in the South Carolina questionnaire about their ASL history, "The program has never been the subject of litigation, threatened litigation, regulatory investigation or supervisory action."</p>
<b>Infrastructure (Technology, DRP)</b>	<p>Deutsche Bank has a variety of in-house systems and third party systems used by the ASL Team:</p> <ol style="list-style-type: none"> <li>1. Risk Management Workstation ("RMW") – Internally developed and only used by the ASL Team. This is the front-end system used by the team for loan bookings, collateral pool investing and for the client level interface (real-time web-based portal).</li> </ol>



	<ol style="list-style-type: none"> <li>2. SunGard Global One – This system is used to set up client information and restriction based rules controlled, which is controlled solely by the middle office team (proper separation for client coding versus lending).</li> <li>3. Bloomberg – ASL uses Bloomberg’s compliance manager (“CMGR”) and Bloomberg order management system (“POMS”) to help monitor client accounts on a pre-trade basis and for trade capture and settlement communications.</li> <li>4. Markit system (formerly known as Data Explorers) – This is an in-depth and time-series analysis of key metrics to compare and evaluate securities lending performance against the market and peers from a macro to individual security level.</li> <li>5. SmartStream and Loanet – Two different vendor solutions used by the bank that help reconcile ASL records against counterparty records.</li> <li>6. Society for Worldwide Interbank Financial Telecommunications (“SWIFT”) – SWIFT is the electronic communication service for ASL messaging between the bank and client custodians.</li> <li>7. Pricing Feeds – ASL uses Bloomberg, Reuters and Interactive Data Corporation for real-time security lending pricing feeds.</li> </ol> <p>The systems outlined allow the ASL Team to analyze and reconcile the security lending market as well as increase their data mining and overall pricing power across the street. In addition, they help control compliance rules and restrictions by analyzing pre and post trade client exposures.</p> <p>Deutsche Bank’s Disaster Recovery and Business Continuity Plan for ASL incorporate four data backup centers:</p> <ol style="list-style-type: none"> <li>1. Jersey City, NJ</li> <li>2. Parsippany, NJ</li> <li>3. Walford, UK</li> <li>4. Croydon, UK</li> </ol> <p>The data centers are backed-up on a real-time basis. These sites are fully controlled and solely used by Deutsche Bank (the bank avoids the co-location model). The centers have the following types of controls in place: uninterruptible power supply, backup generators, redundant sources of communication, smoke and fire detection, sprinkler systems and air testing systems to help monitor heat and humidity levels. In addition to these data centers, Deutsche Bank backs-up physical tapes in an offsite storage facility via Vital Records, Inc. on a daily basis. During Hurricane Sandy (unplanned and recent severe business disruption), the New York office was closed and the ASL Team had to work at Deutsche Bank’s dedicated standby facility in New Jersey. Per DB ASL Senior Management (including ASL IT personnel), the New Jersey contingency site was effective during this period. BCP/DR testing is performed annually and the group responsible for BCP/DR oversight is the Corporate Security and Business Continuity Division.</p>
<b>Transparency and Reporting</b>	<p>Through Deutsche Bank, RSIC will have full transparency that is real-time and without the traditional one day lag. Deutsche Bank clients have access to their web-based system RMW, which will provide robust reporting capabilities for the end user. Reports can be customized to analyze high-level dashboard snapshots, counterparty exposures, detailed historical rebate data points and a variety of compliance monitoring tools. These reports can be aggregated and emailed to specific RSIC staff for easy internal distribution. In addition, Deutsche Bank will deliver peer analysis performance and</p>

	independent benchmark data. The data comes from third party vendors as well as Deutsche Bank's proxy voting alerts using materiality data from Glass-Lewis.
<b>Insurance Coverage</b>	<p>Deutsche Bank reported the following forms of insurance coverage in the South Carolina due diligence question submission:</p> <ol style="list-style-type: none"> <li>1. Crime Coverage (Financial Institution Blanket Bond) with Chubb as primary underwriter using a limit of liability of one hundred and twenty million euros with a one million euro deductible <ol style="list-style-type: none"> <li>a. Protects against employee dishonesty, forgery or fraudulent alteration of securities, which includes loss due to transfer, payment or delivery of funds as a result of fraudulent input, preparation or modification of computer instructions, data, or fraudulent electronic transmissions or communications.</li> </ol> </li> <li>2. Premises and Transit Coverage through lead underwriters Allianz and syndicates of Lloyds of London in the amount of five hundred million USD. <ol style="list-style-type: none"> <li>a. This covers the physical loss of securities while being held or transported.</li> </ol> </li> <li>3. Professional Liability Coverage through Chartis using a limit of liability of two hundred and twenty million euros with a fifty million euro deductible.</li> </ol> <p>ERISA coverage with respect to plans for which the bank acts in a fiduciary capacity.</p>

### Operational Processes and Controls

<b>Service Providers</b>	Deutsche Bank AG had a SOC1 audit (report on the suitability of the design and operating effectiveness of its controls) that was performed specifically on Deutsche Bank's Agency Securities Lending Division. KPMG LLP ("KPMG") last performed this audit on September 30, 2013. ASL received a clean opinion from KPMG's independent auditors report confirming their organizational controls.
<b>Trade Life Cycle Process</b>	<p>The trade cycle for ASL is different from traditional market trading. There are two "trades" that occur in this process: 1. Counterparty Loan 2. Collateral Reinvestment. The third party agent lends out the security in exchange for collateral. The goal for this transaction is to receive the highest intrinsic spread. Intrinsic spread is the loan's profitability when comparing the rebate fee earned and how it compares to Fed Funds or LIBOR. Deutsche Bank focuses on "specials", which are high yielding loans that are in the greatest demand and deemed hard-to-borrow. In the case of specials, loans are at negative rebates to the borrower, allowing the lender to receive a rebate versus paying a rebate to the borrower.</p> <p>When you loan a security, you receive collateral, which can be in the form of cash or securities. The cash collateral can be invested in either repurchase agreements or in money markets, bank deposits, commercial paper, etc. A repurchase agreement is a contractual agreement between two parties. The concept is for party A to sell the security and party B to buy the security at a later date using specified prices. These can be overnight or based on varying term schedules. The potential return of the repo is determined by the following factors: collateral type, maturity length, market environment and the counterparty creditworthiness.</p> <p>Security lending within the industry will traditionally indemnify the client for the loan transaction but will avoid any form of protection to the collateral reinvestment transaction. Deutsche Bank created a specific offering called "Indemnified Repo", which is designed to indemnify the client for any shortfall between the borrower of the security <u>and</u> the cash collateral reinvestment risk.</p>

Deutsche Bank outlines the program details in the ASL January 2014 Dual Indemnification Reference Guide:

In the event of insolvency by a repo counterparty, the Bank indemnifies the client with respect to any shortfall between the liquidation proceeds of securities collateral received from the counterparty and the amount of cash deposited (invested). In the event of a shortfall, the Bank's obligation is to restore the amount of cash that was invested with the counterparty. Again, the indemnification is not conditioned; therefore, it extends to overnight and term repo, as well as traditional and non-traditional collateral types, i.e., all liquid and readily marketable securities.

A positive aspect to Deutsche Bank's indemnified approach is the timing and overall potential market risk of how they make a client whole. Deutsche Bank clients are not subject to any market risk between the timing of the counterparty insolvency and the receipt of those funds. If there is a lag from the insolvency failure to the eventual payment owed, most security lending clients would be paid on the failure date and not on the receivable date (creating unwarranted exposure to market fluctuations). Deutsche Bank clients do not face this risk, since this is determined at the time of the credit that is applied to the account or the actual delivery of equivalent securities (not the date of failure which helps remove the risk of market exposure). This backing assumes Deutsche Bank approves the collateral reinvestment guidelines used by the client.


Under the dual indemnification model, the counterparty exposure risk is effectively reduced to that of Deutsche Bank AG, which is only as good as Deutsche Bank's financial strength and balance sheet. If Deutsche was under distress, this indemnification would be in question. The additional comfort that Deutsche can provide is how they structure the account that holds the collateral for our loans. The collateral for our repos would be held in "separate accounts" in which South Carolina should be able to recall its assets, since they are not in a commingled product. Unlike other lending agents, Deutsche invests in repos in the *client name*. If a pooled account was frozen for any regulatory reason or counterparty insolvency, it would be problematic to access those securities since they are not registered in the clients name. Deutsche Bank outlines the tri-party settlement and process in the following format:


The attractiveness of tri-party settlement is operational efficiency. That means the repo dealer's clearing bank is ideally situated to act as intermediary/collateral custodian on repo financing trades. As such, each clearing bank acts as (tri-party) collateral custodian for the dealers they clear for. So, if the dealer A clears at BNY, anyone who trades repo with Dealer A is going to settle the trades at BNY. Similarly, when one trades repo with a dealer who clears at JPM, the money is sent there for settlement. There is no advantage of using one bank over another. Both segregate and exchange collateral vs. cash, administer the trades and report to trade participants.

The differentiation that Deutsche applies is the account registration. Instead of a pooled account owned by the bank, Deutsche establishes the accounts in the client's name at each of the clearing banks. Security Lending Banks that avoid this registration model provide a bulk ownership approach for the pooled securities. The bulk format is marked for books and record purposes *only* but the account and the account will never be in the client's name.

<b>Valuation Policies and Procedures</b>	<p>The pricing aspect from security lending comes into consideration for the collateral values of the securities held on behalf of the loan (i.e. cash or mix of investment securities). If a loan is not properly collateralized (i.e. drop in market value), the ASL Middle Office Team will request additional funding. If the market value is over collateralized, Deutsche could be asked to send back some of the cash collateral. Typically, the collateral thresholds are set at 102% for cash and domestic securities and 105% for international securities.</p> <p>The other point for pricing is the rerating concept of the existing loan against current market conditions. This is performed by data mining rebate pricing against third party, prime brokerage and street information. The goal for the ASL Team is to monitor the current pricing for the loan and capitalize on rerating opportunities to help maximize intrinsic value.</p>
<b>Cash Management and Control</b>	<p>From a wiring and cash control perspective; Deutsche Bank requires standard settlement instruction (“SSI”) templates to be in place before processing any client related wires. The ASL Team will receive the SSI’s from the client and make sure the client name and bank account details are properly sourced. The ASL Team will verbally confirm the stated instructions with additional staff members at the client level. This allows them to ASL Team to confirm the wire account information with multiple staff members at the client level (additional layer before creating the SSI). All future wires instructed by Deutsche Bank require one creator and two approvers at the bank level before funds can be transferred.</p> <p>On a daily basis, the Middle Office Team will perform a cash reconciliation of the DB RMW system against DTCC and the Federal Reserve (loans will settle between these parties). They will also perform a loan reconciliation of the RMW system against the client custodian reports. Typically, the loan differences are minimal and mostly due to stock reorg events (splits and corporate actions).</p>
<b>Counterparty Risk Management</b>	<p>In regards to bank overall risk, Deutsche Bank employs an Enterprise Risk Management Division with a staff of approximately four thousand people. The Credit Risk Management (“CRM”) team falls under Enterprise Risk Management with a staff of approximately eighteen hundred. CRM reports to Deutsche Bank’s Chief Credit Risk Management Officer. This CRM Team is responsible for the ongoing monitoring of the counterparties credit quality. There are a variety of factors CRM uses for counterparty oversight and threshold limits:</p> <ol style="list-style-type: none"> <li>1. Company reputation and business type</li> <li>2. Company management</li> <li>3. Total capital, asset quality and earnings</li> <li>4. Liquidity, funding and capitalization</li> <li>5. Public credit ratings and material regulatory actions</li> <li>6. Market share, franchise value and overall outlook for the counterparty</li> </ol> <p>CRM evaluates the borrowers, repo counterparties and investments in money market funds. The team will assign bank level counterparty limits based on their ongoing reviews and CRM’s annual review procedures. The assigned limits will be used in the RMW system and cannot be changed by the ASL staff. CRM can rescind and amend these limits based on potential changes of the counterparty’s credit quality. At the ASL level, the middle office will monitor the client’s restrictions and compliance guidelines (i.e. counterparty exposure, investment guidelines, collateral requirements, etc.).</p>

### Administrative Items

<b>History of Due Diligence Performed</b>	<p>December 12, 2013: Mr. Geoff Berg and Mr. Brady O’Connell from HEK discuss Securities Lending and arrange for HEK to provide RSIC with research reports for “Buy” rated Securities Lending providers.</p> <p>December 19, 2013: RSIC receives HEK research reports.</p> <p>December 31, 2013: Mr. Geoff Berg receives an email from Mr. Joseph Santoro at DB</p> <p>January 3, 2014: Mr. Berg has an initial call with Mr. Santoro at DB</p> <p>January 10, 2014: RSIC meet with DB in Columbia, SC</p> <ul style="list-style-type: none"> <li>Attendees from RSIC: Mr. Berg, Mr. Scott Forrest and Ms. Nicole Waites (Investment Team)</li> <li>Attendees from DB: Mr. Santoro, Mr. Anthony Toscano, and Mr. Frank Gambino</li> </ul> <p>February 25, 2014: ODD (Mr. Forrest) meeting on-site with DB in New York</p> <p>April 4, 2014: Call with DB to discuss additional due diligence questions as well as a separate call with RSIC Investment Team and Legal and DB to discuss investment considerations related to indemnified repo.</p>			
<b>Investment Checklist</b>	<b>Checklist Items</b>	<b>Yes</b>	<b>No/Not Applicable</b>	<b>Comments</b>
	<b>Investment Items</b>			
	Received Due Diligence Requested Documents from Manager	<input checked="" type="checkbox"/>	<input type="checkbox"/>	
	Latest fund marketing materials	<input checked="" type="checkbox"/>	<input type="checkbox"/>	There aren’t “fund marketing materials” but we have obtained and reviewed the pitch books from our meetings.
	Meeting agenda and relevant materials from on-site due diligence meeting	<input checked="" type="checkbox"/>	<input type="checkbox"/>	 Deutsche Bank Agenda On Site Visi
	<b>Operations/Audit Items</b>			
	Manager has completed the Operational Due Diligence DDQ	<input checked="" type="checkbox"/>	<input type="checkbox"/>	As this is not a standard “fund” investment, operational due diligence found it more useful to review all relevant back-office materials with DB during the on-site meeting, even though many of these were not formally a part of the DDQ. As a result of the unique investment, the “standard” DDQ was not utilized.
	Operational Due Diligence Director has reviewed the investment	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Approved by Sarah Corbett
	<b>New Investment Procedural Checklist</b>			

Sourcing and Conflicts Disclosure Form is completed by required individuals	<input checked="" type="checkbox"/>	<input type="checkbox"/>	
Manager has delivered the Placement Agent Disclosure Letter	<input checked="" type="checkbox"/>	<input type="checkbox"/>	 Deutsche Bank Certification RSIC Pl
Completed Due Diligence Report	<input checked="" type="checkbox"/>	<input type="checkbox"/>	
Minutes from the IIC regarding investment	<input type="checkbox"/>	<input type="checkbox"/>	<b>Discussed and approved at April 23 IIC meeting, minutes will be saved upon formal adoption of minutes.</b>
<b>STO Checklist Items</b>			
Summary of investment (or identify where this information is in other documents provided) <ul style="list-style-type: none"> <li>• amount and schedule of initial funding</li> <li>• amount and schedule of subsequent fundings</li> </ul>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Summary is available in the Due Diligence Report
Initial funding request from third-party manager	<input type="checkbox"/>	<input type="checkbox"/>	N/A
Copy of the prospectus or other offering document	<input type="checkbox"/>	<input type="checkbox"/>	N/A
LP agreement/contract	<input type="checkbox"/>	<input type="checkbox"/>	N/A
Side letter(s) / agreement(s)	<input type="checkbox"/>	<input type="checkbox"/>	N/A
Fee structure summary (or identify where this information is in other documents provided)	<input type="checkbox"/>	<input type="checkbox"/>	N/A
Name, contact information, and operational due diligence regarding the fund's custodian if assets are to be "out of bank" assets	<input type="checkbox"/>	<input type="checkbox"/>	N/A
Latest SSAE 16 report of the custodian, prime broker, and/or administrator, if any assets will not be in the custody of the STO's custodial bank	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Deutsche Bank's ASL group has a SOC1.
The Treasurer's custodian bank, BNY Mellon, has need	<input type="checkbox"/>	<input type="checkbox"/>	As is customary for any third-party lending arrangement, the client, the third-party

	<p>for a specific agreement with the fund to provide monthly and quarterly reports to the State Treasurer's custodial bank if the investment will result in "out of bank" assets, that is, assets not held by BNY Mellon</p> <ul style="list-style-type: none"> <li>• security/asset description</li> <li>• source account</li> <li>• asset class</li> <li>• sub asset class</li> <li>• base price</li> <li>• base cost</li> <li>• base net income receivable</li> <li>• base net unrealized gain/loss</li> <li>• total base market value</li> <li>• percent of total</li> <li>• any other information required/requested by the Treasurer's custodial bank</li> </ul>			<p>lender, and the Custodian enter into an agreement that governs all aspects of the arrangement.</p>	
	Draft wire instructions for BNYM	<input type="checkbox"/>	<input type="checkbox"/>	N/A	

#### Public Markets Requested Documents Addendum



Deutsche Bank Due Diligence Template -

#### HEK Investment Memo



HEK - Deutsche Bank Recommendat

**Fiduciary Performance Audit  
of the South Carolina  
Retirement System Investment Commission**

***MOVING FORWARD***



**May 1, 2014 Presentation to the  
South Carolina Retirement System Investment Commission**





## Contents

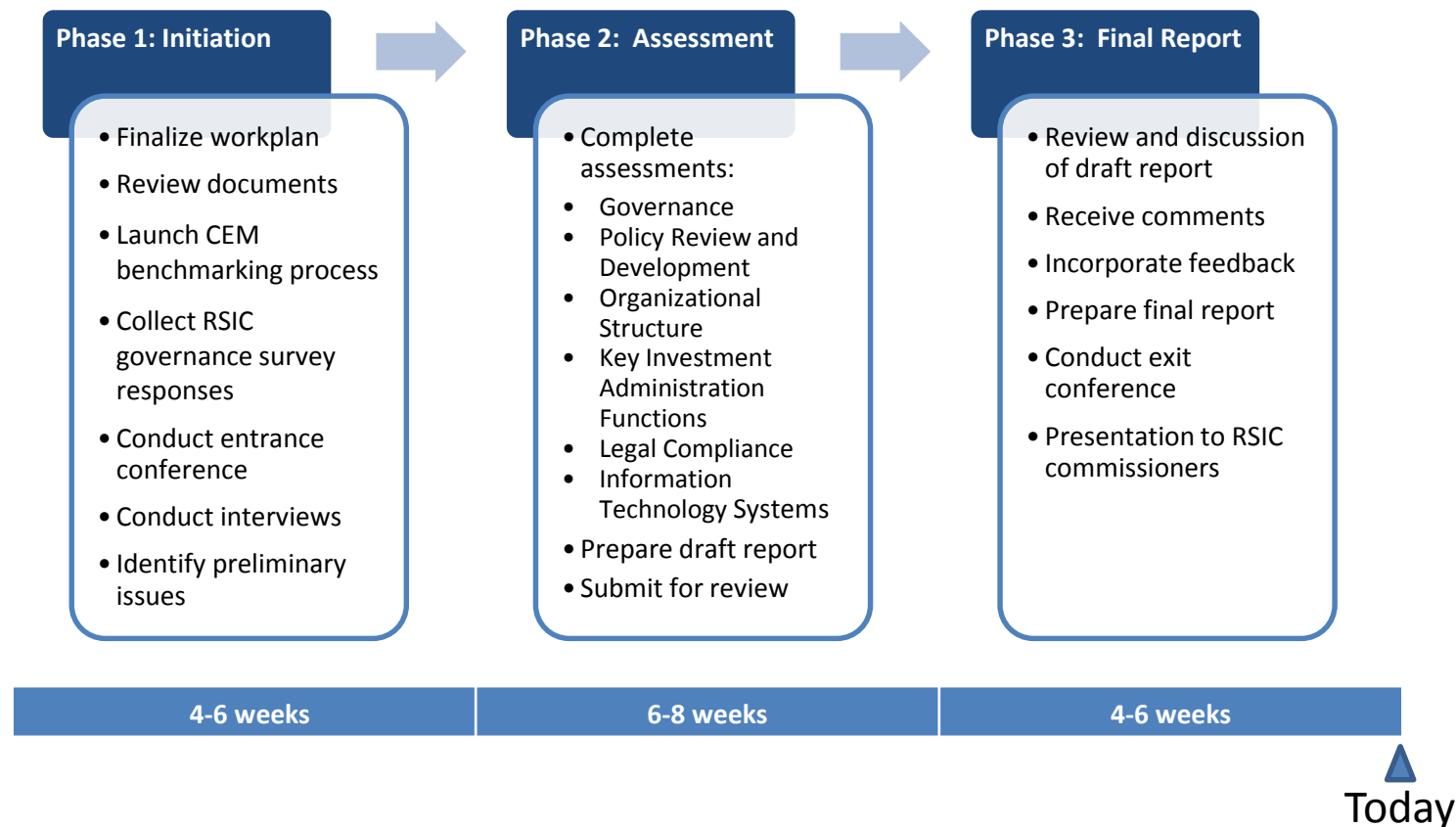
- **Fiduciary Performance Audit Purpose, Process and Product**
- **Overall Conclusions**
- **CEM 2014 Cost Effectiveness Study**
- **Pervasive Themes**
- **Moving Forward**
- **Summary of Recommendations and Priorities that require Commission involvement**
- **Implementation Considerations**
- **About Funston Advisory Services LLC**

## Purpose

- Critically evaluate the fiduciary roles and responsibilities of the RSIC Commissioners and staff, the relationship with other fiduciaries of the Retirement System, and the operational policies and practices of RSIC.
- The goal of the review was to identify areas of strengths and weaknesses, provide comparison with leading practices of other public pension plans, and make improvement recommendations.
- Because RSIC is a relatively new state agency, the review was designed to be broad in nature, spanning all key functions. The review of these functions was organized into six categories:
  - Governance;
  - Policy Review and Development;
  - Organizational Structure;
  - Investment Administration;
  - Legal Compliance; and
  - Information Technology.

## Process

- The audit began Dec. 4, 2013. We reviewed nearly 800 documents and interviewed over 50 people (several multiple times).
- Comments and feedback were received from RSIC, STO and PEBA on Preliminary Recommendations and also on a Draft Final Report.
- The final fiduciary performance audit report was submitted April 18, 2014.



## Product

- **In developing our report, we addressed six fundamental questions:**
  1. Who are the RSIC fiduciaries?
  2. What are their duties?
  3. What are their authorities?
  4. Do their authorities match their duties? Are these duties in conflict with other roles played by the various fiduciaries?
  5. How is the RSIC performing?
  6. Where and how can the RSIC improve?
- **One hundred twenty-four recommendations were identified**
  - 108 can be addressed directly by the RSIC
    - 38 of these require the direct involvement of the Commissioners
  - 12 require action by the Legislature
  - 4 require action by the State Treasurer's Office
- **The primary purpose of today's presentation is to discuss priorities and implementation considerations that directly involve the Commissioners, the Legislature and STO.**

## Overall Conclusions

1. There are no red flag indicators of malfeasance or misfeasance regarding the Commission's current policies and practices. Same findings as SIG.
2. Investment fee transparency, policies and controls have improved significantly; disclosure of total external management fees is the most complete in the industry.
3. Recent RSIC manager selection and due diligence processes are consistent and thorough, although sometimes slower than industry norms.
4. RSIC has been implementing a number of strategies which should result in lower external manager costs. The lagging development of infrastructure results in growing operational risks, and ultimately financial risk.
5. RSIC has already implemented many improvement initiatives over the past two years.

## CEM 2014 Cost Effectiveness Study

A new independent investment cost effectiveness study by CEM concluded:

1. RSIC's portfolio strategy has underperformed its peers over the five year period ending December 31, 2012. This was also true for other funds with asset allocation strategies similar to RSIC, i.e., larger allocation to alternative investments.
2. RSIC staff has been able to add value above the asset allocation policy through its management of the investment portfolio.
3. RSIC's management costs for CY2012 were 103.0 bps, compared to the peer average of 61.1 bps. RSIC's management costs were highest in the peer group, largely due to the heavy weighting to alternatives and their associated higher costs.
4. When compared to other funds with similar asset allocations, RSIC's external management fees are normal and not excessive.

## Pervasive Themes

Synthesizing the findings across the six categories we reviewed, we identified five overall themes for improvement:

1. Improve assurance and independent reassurance to build trust and confidence.
2. Build capabilities across the organization (including HR, IT, Accounting, etc.).
3. Reset Commissioners' focus on strategy and oversight.
4. Align fiduciary duties and responsibilities.
5. Improve the custodian relationships.

Specific recommendations to the Commission, the Legislature and STO are organized by each of these themes. Key points relative to each theme are shown in **bold**.

## Moving Forward

- Fiduciaries must have timely access to information needed for oversight.
- Commissioners don't need to agree on everything, but they must treat each other with respect and courtesy – the personal attacks must stop.
- Over the past few years, RSIC has had deficiencies in infrastructure; it was important to address the situation quickly and they have.
- The Commission needs to pay more attention to the non-investment side of RSIC's operations; the emphasis should be on strategy and oversight, not review and management of operational details.
- RSIC staff is very capable and have made considerable improvements over the past three years but the environment must improve to limit turnover.
- Commissioners need to ensure they avoid even the appearance of impropriety.
- Commissioners should address the challenge of explaining the asset allocation and use/cost of external managers to all stakeholders, especially the Legislature.
  - The current asset allocation is a complex and costly form of insurance against catastrophic drawdowns.
  - RSIC reports more external manager fees than any other fund.
  - Ongoing fee benchmarking is needed to ensure costs are appropriate.
- The Legislature can significantly help improve RSIC through better alignment of responsibilities and authorities.



# 1. Improve assurance and independent reassurance to build trust and confidence.

- **Trust is a two way street**
- **Make better use of independent reassurance to ensure confidence in operations is justified**
- **Rebuild stakeholder relations, especially with STO and the Legislature**

The Commission should:

1. Develop a more proactive communications plan to make the Commission's positions understandable to key stakeholders G18
2. Retain an independent fee benchmarking service G13.4, P4.2, I11.2
3. Formalize the fee disclosure policy I11.1
4. Oversee the development and deployment of ERM L4.3
5. Create a single point of executive accountability G4, O1.1
6. Approve the Internal Audit Charter G13.1
7. Improve Sourcing and Conflict disclosures P2.9
8. Disclose Personal and Financial Distress P2.6
9. Oversee improved budget management G5.2

## 2. Build capabilities across the organization (including HR, IT, Accounting, etc.).

- **Build capabilities to ensure staffing and infrastructure keep pace with the investment strategy**
- **Improve the budgeting and budget management process**
- **Improve IT support**

The Commission should:

1. Create the position of CEO or Executive Director O1.1
2. Create a Senior HR position and function O3.1
3. Oversee development of an enterprise infrastructure and resourcing plan O2, O3.6, O3.7, IT1.1
4. Oversee further development of risk management systems and capabilities I3
5. Eliminate the 30-day review period on investments L3.1
6. Provide midyear feedback to executives G14
7. Evaluate the performance of the general investment consultant I16
8. Ensure development of an IT staffing plan and IT capabilities IT2

### 3. Reset Commissioners' focus on strategy and oversight.

- **Commission's role is oversight not management**
- **Need more strategic not operational emphasis**
- **Timely information is needed for strategic decision making and oversight**

The Commission should:

1. Develop a statement of investment beliefs G10.1, P1.2, I2
2. Increase emphasis on review and discussion of asset class strategies G10.2
3. Ensure organizational capabilities are developed/maintained I4.1, O3.2
4. Preclude direct involvement in due diligence G10.3, P1.1, P1.3, G10.3 IT1.1
5. Expand mandate of Audit Committee to include ERM G13.3.
6. Expand mandate of Compensation Committee to include HR G15.1
7. Hold more frequent Commission meetings L3.2, G12.1, I6.1
8. Annually review implementation of Compensation policy P4.1
9. Formalize the revised agenda setting process G12.2
10. Improve Commission self-assessment G12.3
11. Institute a Commissioner self-development program G12.4

## 4. Align fiduciary duties and responsibilities.

- **Ensure authorities match fiduciary responsibilities**
- **Authorities should be clear and not in conflict**

### 1. The Legislature should:

- a. Clarify the role of BCB and its successors G1
- b. Resolve the Treasurer's conflicting duties G2
- c. Revise legislation to allow a CEO/Executive Director and change in CIO reporting (but not access) G4
- d. Delegate operating budget, staffing and compensation approval to RSIC G5.1
- e. Authorize an external audit or agreed upon procedures review of fund valuations, procedures and/or controls G6
- f. Revise Commissioner qualifications to recognize experience G8.1
- g. Add 1 to 3 additional Commission members G8.2
- h. Consider term limits for Commissioners G9
- i. Require a periodic rate of return process and assumption review I1

### 2. BCB should allow a modified information systems procurement process P5, IT4.1

### 3. The Attorney General should set high level criteria and delegate sourcing of external counsel to RSIC L5.2

## 5. Improve the custodian relationships.

- **Ensure the RSIC has the custodial services it needs to do its job**
- **Align responsibilities to facilitate efficient and effective custody operations**

### 1. Legislature should:

- a. Consider options to improve the custodial relationship I17
- b. Delegate selection of custodial bank to RSIC G3, I17

### 2. Treasurer should:

- a. Review positions required to sign to release of cash transfers P3.2
- b. Instruct the custodial bank to accept signatory changes from RSIC P3.3
- c. Continue to allow standing instructions for the custodial bank to receive incoming funds and sweep cash P3.1
- d. Allow electronic payment authorization P3.4

### 3. Commission should determine future of Securities Lending I18.1, 18.2,

## Implementation Considerations

- With input from RSIC, a matrix has been prepared which describes for each recommendation:
  - Criticality
  - Degree of difficulty
  - Commission involvement needed
  - Outside entities involvement/support needed
- The Commission has already taken a number of steps to implement our recommendations.
  - Ad Hoc Planning Committee was formed to review the FAS report and develop a strategic plan in collaboration with RSIC staff and has developed a charter and selected a chairperson; it has already met several times.
  - Appropriate staff members have been identified for each recommendation (subject to Planning Committee approval) and the Planning Committee has begun work with staff to develop plans to address priorities identified by the Committee.
  - The Planning Committee intends to make recommendations during the May 1st Commission meeting.

## Maintaining the Momentum

- This review is the first in a series of annual fiduciary performance reviews and contains over 120 recommendations for improvement targeted at the Commission, the Treasurer, the Legislature and others.
- It will take some time and resources for the timely implementation of those recommendations which are accepted.
- We suggest that the scope of such reviews for the next several years be more focused on the status of implementation and a review of priority areas.
- The Commission's enthusiastic and early embrace of our recommendations is most encouraging as a demonstration of its commitment to continue to fulfill its fiduciary responsibilities, develop its capabilities and move forward.
- We sincerely hope this report is of value to the RSIC, the beneficiaries of the fund and its key stakeholders as the Commission continues to develop its capabilities, fulfil its fiduciary responsibilities and maintain its forward momentum.

## About Funston Advisory Services LLC

- Formed in 2010, Funston Advisory Services LLC (FAS) is a Michigan based firm.
- The core competencies and experience of the FAS team include governance, strategy, risk, compliance, investment operations, investment accounting, and stakeholder engagement.
- Over the past three years, FAS has demonstrated its ability to address complex fiduciary and governance issues in public pensions at:
  - The California Public Employees' Retirement System (CalPERS),
  - The Oregon Office of the State Treasurer and Oregon Investment Council,
  - The Common Retirement Fund ("CRF") managed by the Office of the New York State Comptroller,
  - And the School Employees Retirement System (SERS) of Ohio.



## The FAS Team on the RSIC Engagement

- Rick Funston, Managing Partner and former national practice leader for Deloitte's Governance and Risk Oversight Services.
- Randy Miller, Principal, former Deloitte senior consulting partner.
- Keith Bozarth, retired Executive Director of the State of Wisconsin Investment Board (SWIB) (June 2012) (9th largest public pension fund in the United States) and prior CEO of the Orange County Employees Retirement System in California.
- Marv Damsma, former Chief Investment Officer for BP America, The Kellogg Company and the New York City Retirement Systems.
- Virginia Brizendine, Chief Financial Officer for the School Employees Retirement System (SERS) of Ohio from 1999 until 2010.
- Keith Johnson, attorney and Chair of the Institutional Investor Legal Services team at Reinhart Boerner Van Deuren S.C. and former legal counsel to the State of Wisconsin Investment board (SWIB) for more than 21 years.
- Ken Johnson, former Chief Operating Officer and Chief Financial Officer for the State of Wisconsin Investment Board (SWIB) (retired in 2010).
- Jon Lukomnik, former Deputy Comptroller for pensions for the City of New York, currently serves on three investment committees, is a trustee for the Van Eck mutual fund complex and a member of their Audit Committee.

# Performance Update

As of February 28, 2014

**May 1, 2014**



# Performance – Capital Markets

As of February 28, 2014

Market Performance	Month	3 Month	YTD	FYTD	1 Year	2 Years	3 Years	5 Years
80% Russell 3000 / 20% MSCI EAFE+300 Bps 3-month lag	2.59%	11.28%	6.36%	<b>18.23%</b>	33.39%	25.64%	19.36%	20.58%
MSCI All-Country World Index Net	4.83%	2.37%	0.64%	<b>16.53%</b>	18.16%	13.64%	8.35%	19.58%
50% MSCI World / 50% S&P/Citi WGBI	3.22%	2.59%	1.98%	<b>11.27%</b>	11.10%	7.86%	6.11%	12.24%
NCREIF Open-end Diversified Core (ODCE) Index+75 Bps	0.06%	3.78%	0.12%	<b>8.20%</b>	13.79%	13.07%	15.02%	1.45%
Dow Jones-UBS Commodity Index	6.24%	7.87%	6.55%	<b>7.68%</b>	-1.84%	-4.80%	-6.86%	4.90%
HFRI Fund weighted Composite Index	1.96%	2.50%	1.43%	<b>7.25%</b>	7.87%	5.95%	3.15%	8.38%
1/3 BC U.S. HY, 1/3 S&P/LSTA Leveraged Loan/1/3 BC MBS	0.85%	2.01%	1.83%	<b>5.03%</b>	4.59%	5.85%	5.64%	11.74%
S&P/LSTA Leveraged Loan + 150 Bps on a 3-month lag	0.61%	1.83%	1.46%	<b>3.63%</b>	7.31%	9.07%	7.27%	15.14%
Barclays Global Aggregate Bond Index (Hedged)	0.49%	1.38%	1.94%	<b>3.00%</b>	1.74%	3.04%	4.33%	4.70%
Barclays US Aggregate Bond Index	0.53%	1.44%	2.02%	<b>2.46%</b>	0.15%	1.63%	3.83%	5.13%
50% JPM EMBI (USD) / 50% JPM GBIEM (Local)	3.48%	0.71%	0.73%	<b>1.11%</b>	-5.83%	1.13%	4.15%	11.36%
Barclays 1-3 Year Government/Credit Index	0.13%	0.20%	0.33%	<b>0.90%</b>	0.81%	0.94%	1.21%	2.07%
Merrill Lynch 3-Month T-Bill	0.07%	0.09%	0.18%	<b>0.44%</b>	0.40%	0.42%	0.64%	0.96%



# Performance – Plan and Asset Class (as reported)

As of February 28, 2014

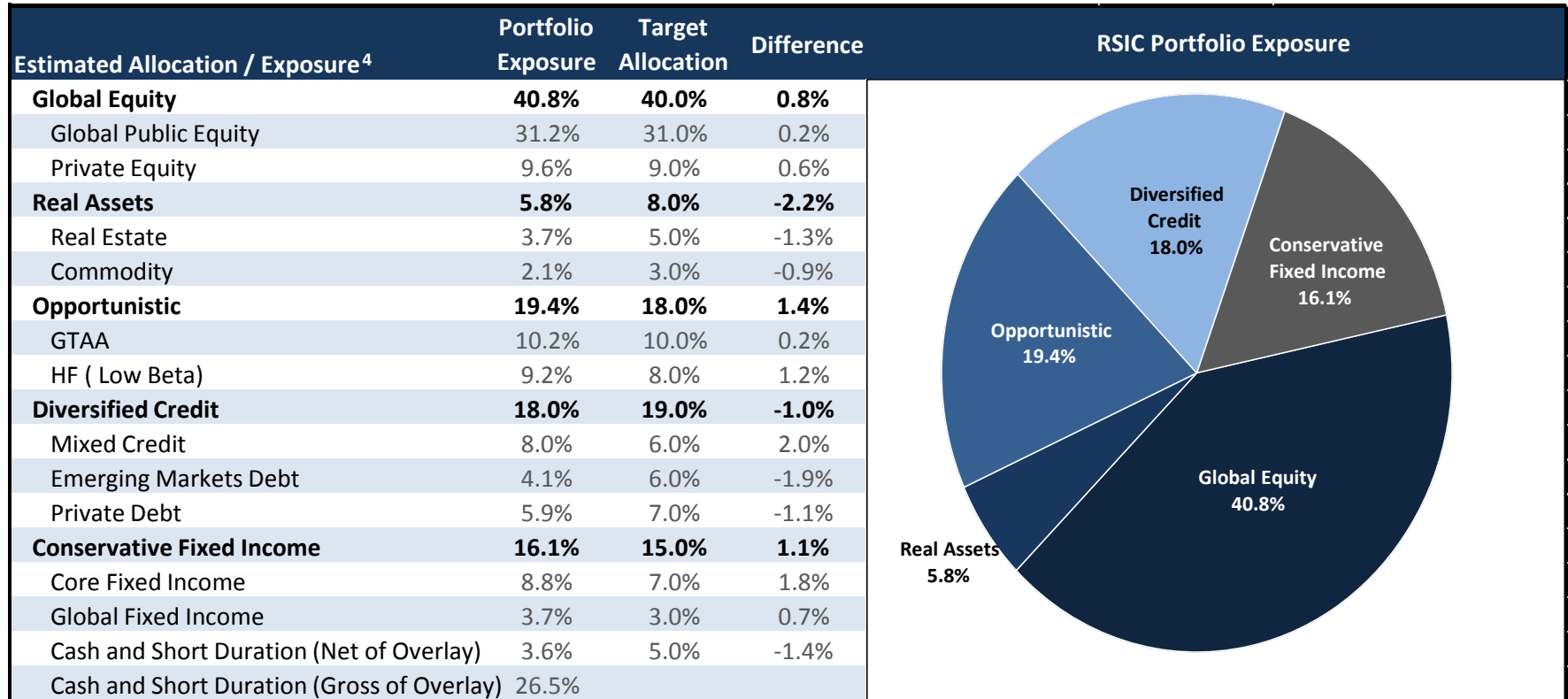
Executive Summary <sup>1</sup>	Mkt Val <sup>2</sup>	Month	3 Month	YTD	FYTD	1 Year	2 Years	3 Years	5 Years
<b>TOTAL PLAN (Net of Fees)</b>	<b>\$28,909</b>	<b>2.62%</b>	<b>2.85%</b>	<b>1.57%</b>	<b>10.51%</b>	<b>10.90%</b>	<b>9.78%</b>	<b>7.67%</b>	<b>13.74%</b>
<i>POLICY BENCHMARK</i>		2.76%	3.10%	1.78%	10.00%	10.31%	8.55%	6.97%	12.27%
Relative Performance		-0.14%	-0.25%	-0.21%	0.51%	0.59%	1.23%	0.70%	1.47%
<i>Cumulative Benefit Payments (Net)</i> <sup>3</sup>		(\$55)	(\$223)	(\$183)	(\$692)	(\$1,041)	(\$2,021)	(\$3,006)	(\$4,750)

Active Managers Performance <sup>1</sup>	Mkt Val <sup>2</sup>	Month	3 Month	YTD	FYTD	1 Year	2 Years	3 Years	5 Years
<b>TOTAL PLAN</b>	<b>\$28,909</b>	<b>2.62%</b>	<b>2.85%</b>	<b>1.57%</b>	<b>10.51%</b>	<b>10.90%</b>	<b>9.78%</b>	<b>7.67%</b>	<b>13.74%</b>
<i>POLICY BENCHMARK</i>		2.76%	3.10%	1.78%	10.00%	10.31%	8.55%	6.97%	12.27%
Global Public Equity	\$4,293	4.32%	1.40%	-0.19%	14.80%	12.63%	11.15%	6.86%	20.71%
Private Equity	\$2,783	0.84%	6.04%	2.29%	12.07%	20.81%	16.34%	14.20%	11.52%
Real Estate	\$1,064	0.70%	4.32%	1.08%	11.74%	19.41%	15.71%	10.97%	8.53%
HF (Low Beta)	\$2,663	2.26%	3.50%	2.68%	10.38%				
Private Debt	\$1,698	1.71%	3.89%	1.88%	10.15%	16.21%	14.62%	9.73%	14.98%
GTAA	\$1,919	3.11%	2.34%	2.27%	8.83%	5.38%	6.88%	8.62%	12.62%
Mixed Credit	\$2,316	1.42%	3.16%	2.24%	7.50%	7.99%	9.07%	5.74%	15.72%
Global Fixed Income	\$1,065	2.03%	2.33%	2.25%	4.86%	0.89%	3.56%	4.56%	11.58%
Core Fixed Income	\$2,542	0.43%	1.51%	2.09%	2.66%	0.15%	2.38%	4.30%	6.21%
Short Duration	\$3,485	0.15%	0.28%	0.32%	1.36%	1.30%	1.63%	1.78%	
Commodity	\$0								
Cash	\$2,750	0.03%	0.01%	0.03%	-0.02%	1.26%	-0.67%	0.10%	0.13%
Emerging Market Debt	\$896	3.53%	0.00%	0.29%	-0.34%	-7.68%	0.69%	2.98%	



# Portfolio Exposure\*

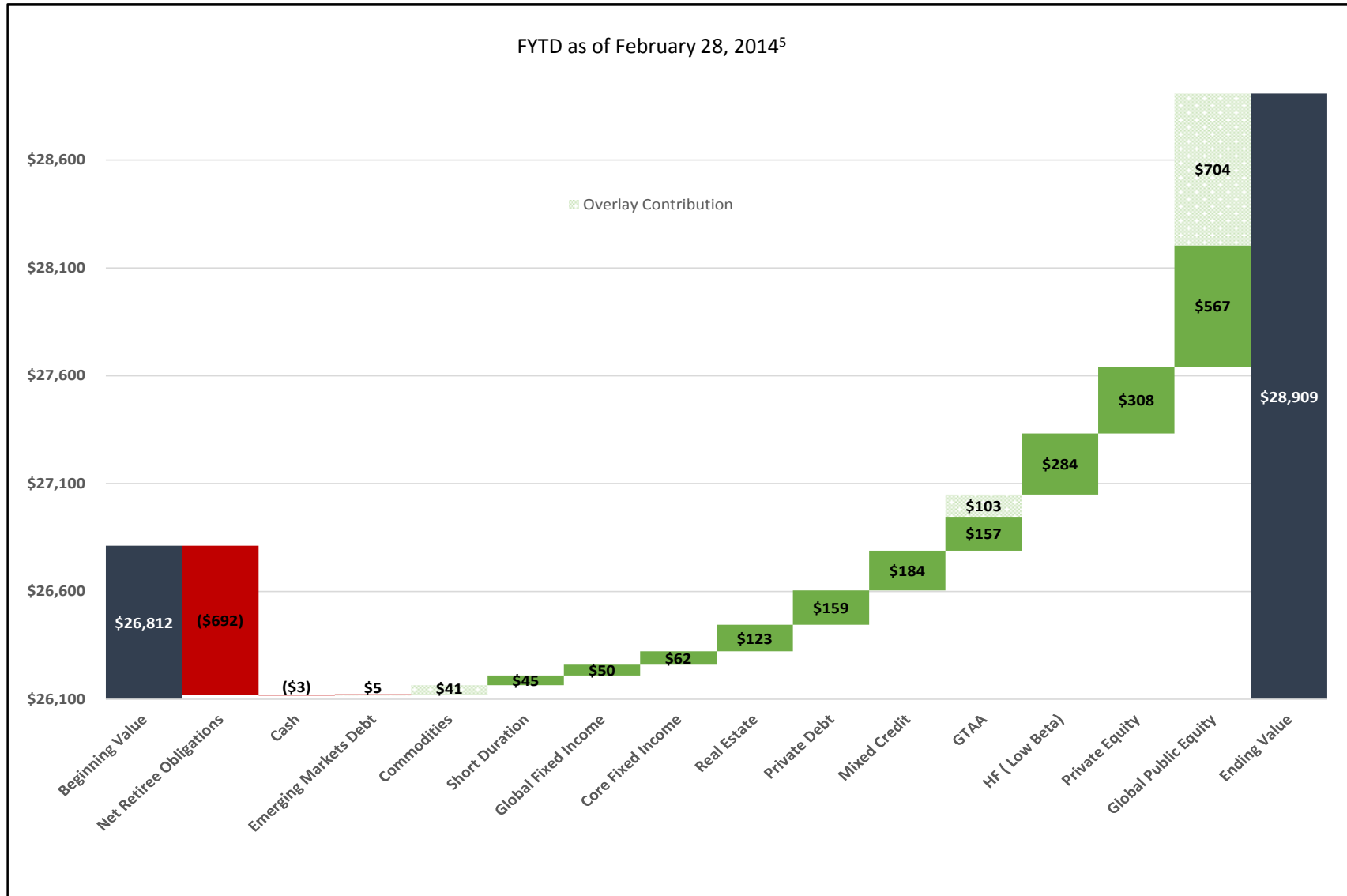
As of February 28, 2014



\*Portfolio exposures include the notional exposures from the Overlay

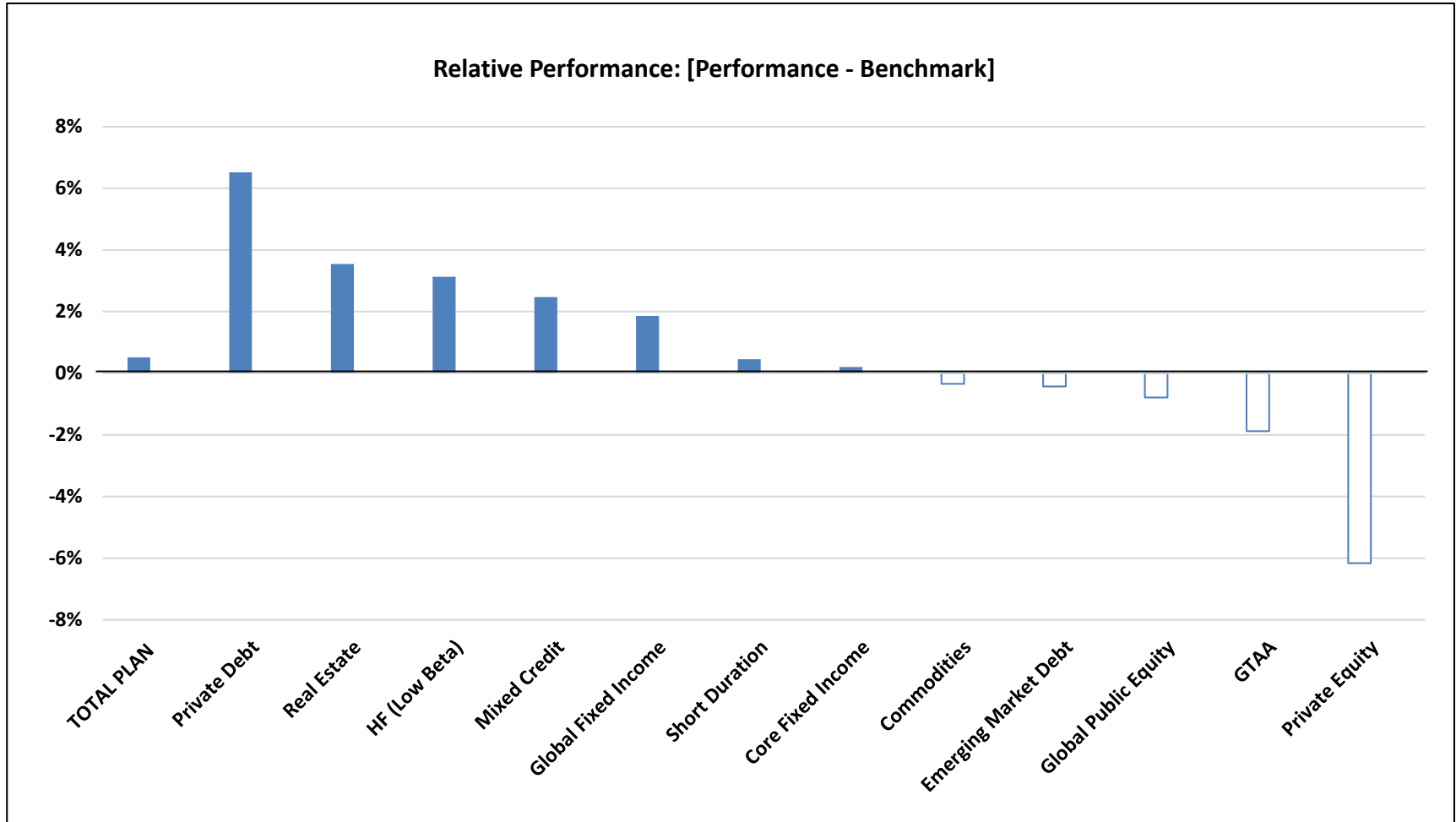


# Fiscal YTD Performance by Asset Class



# Asset Class Performance vs Policy Benchmarks

As of February 28, 2014



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## Footnotes and Disclosures:

<sup>1</sup>Source: BNYM

<sup>2</sup>Market values in Millions

<sup>3</sup>Benefit payments are net contributions and disbursements from the trust fund

<sup>4</sup>Source: RSIC Internal Analysis and Reporting

<sup>5</sup>Estimated using contribution to return by asset class which is calculated by taking the [beginning weight \* return] on a monthly basis. Source: BNYM and Russell. Cash and Partnerships include the impact of fees and expenses associated with Strategic Partnerships.

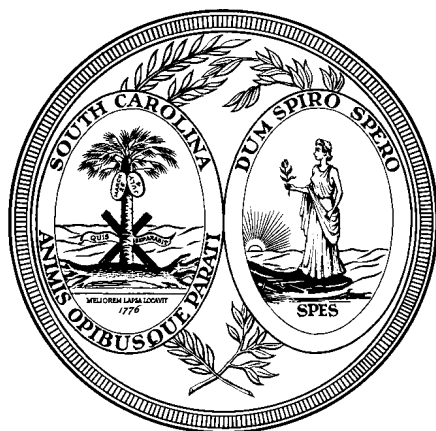
Returns are provided by BNY Mellon and are time-weighted, total return calculations. Net of fee performance is calculated and presented after the deduction of management fees and trading expenses. All market values and returns are expressed in U.S. Dollars. Periods greater than one year are annualized. Past performance is no guarantee of future results.





**SOUTH CAROLINA RETIREMENT SYSTEM  
INVESTMENT COMMISSION**

**ANNUAL INVESTMENT PLAN  
FISCAL YEAR 2014-2015**



as adopted by the Retirement System Investment Commission  
on April XX, 2014; effective on July 1, 2014

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SECTION 1. OVERVIEW AND PURPOSE..... 2

SECTION 2. STRATEGIC INITITATIVES..... 2

SECTION 3. INVESTMENT STRATEGIES AND TRANSITION..... 3

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## SECTION 1: OVERVIEW AND PURPOSE

### Overview

Annually, the Commission adopts a Statement of Investment Objectives and Policies ("SIOP"), which provides the objectives, policies, and guidelines for investing the assets of the South Carolina Retirement Systems (the "Fund" or the "Plan"). The SIOP provides the framework by which the RSIC, at the direction of the Chief Investment Officer ("CIO"), drafts a proposed Annual Investment Plan ("AIP"). South Carolina law requires the CIO to submit the proposed AIP to the Commission no later than April 1<sup>st</sup> of each year, and the Commission must adopt a final AIP no later than May 1<sup>st</sup> of each year for the following fiscal year which begins on July 1. The Commission may amend the AIP during the fiscal year as it deems appropriate.

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### Purpose

The purpose of the AIP is to provide a formal document for investing and managing the Retirement System's assets to achieve the Commission's investment objectives and mission as stated in the SIOP, which is incorporated therein. The relevant portion of the SIOP may constitute parts of the AIP pursuant to Section 9-16-50(B). The Commission adopts the SIOP, in its entirety, into the AIP, in accordance with Section 9-16-50(B) and to satisfy compliance with the requirements of Section 9-16-330(B).

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## SECTION 2: STRATEGIC INITIATIVES

Each year the Investment Staff undertakes initiatives approved by the Investment Commission within the AIP with the goal of improving capabilities and performance of the Plan. Staff will continue working on prior initiatives set by the Commission, which include:

- Develop a Statement of Investment Beliefs that will become part of the AIP once adopted by the Commission.
- Implement the outcome of the RFPs for risk management ~~and~~, administrative services, ~~and private markets systems.~~
- Build the accounting and administrative functions to support the reporting requirements of the Commission.
- Incorporate the trade order management and portfolio management systems required to support the current assets managed internally.
- Build out risk systems, including working with the development of the Enterprise Risk Management function.
- Create a dedicated Human Resources function to develop and lead the overall human resource strategy for the RSIC. ~~Continue to actively recruit for open positions and re-allocate existing positions as the organization's needs evolve.~~
- Re-structure the Strategic Partnership model ~~and explore use of~~, ~~designing a customized fund-of-one solutions to be used with existing and new key~~ several of the partners for both traditional and alternative assets and investment strategies.
- Continue to rationalize the external manager allocations to achieve the most efficient portfolio implementation strategy.

- Grow the internal investment research function to serve as a key input for all investment decisions across the organization, focusing primarily on investment strategy, tactical asset allocation, and direct/co-investment opportunities.
- ~~Concurrently evaluate the capacity to expand internal asset management as the systems and business infrastructure implementation is finalized.~~
- Continue to negotiate for lower fees and better terms with managers.

The staff's ability to address these initiatives may be impacted by the budget approval process. These initiatives may also be amended by the Commission based on the recommendations from the fiduciary audit by Funston Advisory Services, LLC.

### SECTION 3: INVESTMENT STRATEGIES AND TRANSITION

#### Strategic Partnerships

The Commission has approved several Strategic Partnerships, which are customized, flexible, and opportunistic investment mandates ~~implemented via separate corporate structures or legal entities~~ managed jointly by RSIC and an external investment manager. Each Strategic Partnership has an Investment Committee overseeing its operations and investment mandate. The Investment Committee in each case consists of several members from the general partner (the external manager) and either one or both of RSIC's Chief Investment Officer and Deputy Chief Investment Officer as delegated by the Commission and as outlined within each Strategic Partnership agreement. The Strategic Partnerships follow a similar approval process for each investment, which requires that each new investment or ~~investment strategy~~ undergo due diligence by the investment manager and RSIC Staff, ~~be reviewed by the Commission's consultant~~, be approved by the RSIC's Internal Investment Committee, and then receive unanimous consent of the Strategic Partnership's Investment Committee.

~~The Commission's Investment Consultant will be informed of the investment decisions within each Strategic Partnership, serve as an a key input to the IIC as needed, provide a prudence memo to the Commission as requested for individual proposed investments strategies, and maintain due diligence records on each Strategic Partnership.~~

The governing body of each Strategic Partnership maintains and manages policies, procedures, and budgets for the respective entity.

~~Staff will be implementing approved changes by the Commission and recommending additional changes to the Strategic Partnerships during fiscal year 2014.~~

#### Asset Class Policy Targets and Commentary

Staff, in conjunction with the Consultant, recommends no change to the Policy asset allocation for the

fiscal year ending 2015. The recommendation to maintain a conservative asset and risk allocation is driven from analyzing the liabilities and the financial health of the Retirement Systems. We believe that the current Policy asset allocation will achieve the goals and objectives of the Commission over a long term horizon. Recommendations will be made to the Commission to amend the asset allocation as warranted. Over the shorter term, Staff will continue to monitor the economic environment and make asset allocation tilts within the portfolio, maintaining compliance with the SIOP.

The Investment Staff will review and seek ways to create a more efficient implementation within a number of asset classes, utilizing a combination of passive, active, enhanced, and hedged strategies. The goal of this review and future recommendations to the Commission will be to further enhance the risk-return ratio while still achieving growth, income and stability of the assets.

**Global Equity**

The Global Equity target asset allocation consists of 31% to public~~ally~~ traded securities and 9% to private equity, for a total of 40%.

Global Public Equity

Currently, the portfolio is diversified across the various regional components (United States, Developed World ex-United States, and Emerging Markets) of the policy benchmark for global public equity, the MSCI All Country World Index ("MSCI ACWI"). ~~United States, Developed World ex-United States, and Emerging Markets.~~ The portfolio is managed to maintain similar weights of the regional components of the index. As a result, the United States has the largest allocation making up approximately 50% of the global public equity allocation, with Emerging Markets being the smallest at roughly 10% of the global public equity allocation. Within the United States, the portfolio has an overweight to small capitalization stocks, which traditionally have a higher beta to the ~~Policy benchmark, the MSCI All Country World Index ("MSCI ACWI")~~.

For FY 2014-15, there will be a focus on transitioning the portfolio from specific regional components to a more global structure. In addition, Staff will be exploring enhanced index strategies as ~~one area that will provide the~~ a method of providing flexibility ~~of-in~~ transitioning to a more global portfolio structure, while balancing passive and active strategies. Enhanced ~~index-index~~ strategies tend to be low to modest tracking error strategies that are the result of small, factor-based deviations from an index. The result of this strategy can be a higher information ratio, which implies more consistency around generating excess returns.

Market exposure will continue to be maintained through allocating to managers as well as through the Overlay program. Staff expects to use a combination of active, passive, enhanced, and hedged strategies within ~~this asset class~~ global public equity.

Private Equity

Currently, there is a slight over allocation to private equity with current levels at 9.6% of plan Plan assets. The pacing for the coming year is expected to be approximately ~~\$300~~ \$150-450M, ~~depending upon, and subject to changes in, market conditions, pacing requirements and other factors.~~

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For FY 2014-15, there will be a focus on making commitments to the Energy, Growth Equity, and Buyout segments of the asset class. Energy, in particular, presents multiple compelling long term opportunity sets.

In addition to fund commitments, staff is pursuing a variety of methods to execute on co-investment transactions. Co-investments are a way to invest in managers' best ideas at favorable economics, and they are expected to generate excess returns. ~~Currently, we are~~ Staff may pursuing pursue co-investment opportunities ~~from-sourced both by Strategic Partners, and -but staff is also looking at additional opportunities from certain those~~ managers who are not formal Strategic Partners.

#### Real Assets

Real Estate and Commodities are the components of the Real Assets policy allocation. Real Estate's policy weight is 5% and Commodities' ~~remains at~~ 3%. Staff will assess adding other investment strategies within this category, such as infrastructure.

#### Real Estate

As of February 2014, the Real Estate asset class ~~is currently was~~ underweight at 3.9% of plan assets. This is primarily due to the call down nature of investing in private market strategies. The pacing schedule for FY 2015 is expected to be ~~approximately \$250-125-300 million, depending upon, and subject to changes in, market conditions, pacing requirements and other factors.~~ Staff anticipates committing a large portion of this allocation to core real estate. Staff is working with several managers to determine the feasibility of a separate account structure to build this allocation over the next several years.

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#### Commodities

As of February 2014, the Commodities allocation was approximately 2% of Plan assets, an underweight of 1%. As a result of hedge fund reclassifications and terminations, the Commodities allocation is ~~now~~ presently implemented entirely through the Overlay program, using swaps for passive benchmark and roll-select implementations. ~~For During~~ FY 2014-15, Staff will seek to add trading strategies and explore merchant-based (hold physical positions) commodity investment strategies.

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#### Diversified Credit

The Credit category is included in return-seeking assets with a target allocation of ~~18~~19%. This category includes a 6% allocation to Mixed Credit, a 6% allocation to Emerging Markets Debt and a 7% allocation to Private Debt.

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#### Mixed Credit

Mixed credit is made up a variety of non-core fixed income investments, including high yield bonds, bank loans, credit-oriented hedge funds, mortgages and asset backed securities. As of February 2014, the Mixed Credit allocation was 8.2%. ~~While this is overweight which exceeded~~ the target allocation by 2.2%. ~~This allocation will be reduced and brought back closer to Policy. Staff will review high yield bond and bank loan managers, and recommend changes, as warranted.~~

#### Emerging Market Debt

Emerging Market Debt has a policy target of 6% and ~~is currently as of February 2014, was~~ underweight at 4.1%. The asset class is divided into debt issued in US dollars and debt issued in each country's local

currency. Staff will conduct new manager searches in this area.

#### Private Debt

The Private Debt asset class has a target allocation of 7% of total plan assets. ~~Currently~~ As of February 2014, the allocation is approximately 5.9%. For 2014-15, there will be a focus on commitments to Energy Debt opportunities (to complement the Energy Equity invested in the PE portfolio), Direct Lending, and Mezzanine investments. Distressed Debt generally has compelling opportunities despite the market cycle, and is usually industry- and company-specific.

#### Opportunistic

The Opportunistic asset class includes ~~a dedicated Low Beta Hedge Fund allocation of 8% both low beta hedge fund and GAA strategies~~. The category is expected to improve diversification (i.e., decrease risk) of the Fund as a result of asymmetric performance – reasonable positive contributions to the Fund while avoiding significant drawdowns.

Hedge fund strategies can be implemented through the Low Beta Hedge Fund classification or through ~~traditional~~ the following asset classes: Global Public Equities, Long Equities, Mixed Credit, Commodities, GTAA/Risk Parity, Emerging Markets Debt and Private Debt. When hedge funds are utilized in a traditional asset class, its benchmark will be consistent with the asset class, and when classified as a Low Beta Hedge Fund, the benchmark is the HFRI Fund Weighted Composite Index. In total, ~~h~~ Hedge funds have a maximum target of 15% of plan assets.

~~The Opportunistic asset class also includes a 10% allocation to Global Asset Allocation (GTAA/Risk Parity) strategies.~~

#### Hedge Funds

The current portfolio has hedge funds in three asset classes: Low Beta Hedge Funds, Global Public Equities and Mixed Credit. For FY 2014-15, Staff will continue to focus on optimizing the Low Beta Hedge Fund portfolio to reflect high conviction, market neutral strategies.

The use of hedge funds in ~~the traditional~~ asset classes noted above will continue to be reviewed on a case-by-case basis to ensure that the structure of the investment is appropriate for a higher beta strategy.

#### Global Asset Allocation

~~The Opportunistic asset class also includes a 10% allocation to Global Asset Allocation (GTAA/Risk Parity) strategies.~~ This asset class has historically included both Global Tactical Asset Allocation and Risk Parity strategies. Approximately 35% of the exposure to the asset class is passive. During the year, Staff intends to evaluate new strategies with the expectation of converting the passive exposure to actively-managed, alpha-oriented strategies. Any new strategies will be funded through a reduction to the existing passive exposure.

#### Conservative Fixed Income

The Conservative Fixed Income asset class is intended to provide ~~a~~ the primary source of diversification as a lower risk, liquid, short duration, and/or high credit quality component of the Fund. The category is also managed as the primary source of capital to pay benefit obligations. Within the Conservative Fixed

Income category, the Policy target allocations to Cash/Short Duration ~~will be~~ 5% in total, Core Fixed Income ~~will remain~~ at 7%, and Global Fixed Income ~~remains~~ at 3%.

Staff plans to initiate a broad, comprehensive review of ~~its~~ the entire Conservative Fixed Income asset classes over the coming year.

#### Core Fixed Income

The ~~current~~ allocation ~~is as of February 2014, was~~ 8.9%; however, this level is likely to decline as capital is shifted to other asset classes that are currently underweight. While there is a clear diversification benefit ~~of the~~ offered by this asset class, the current forecasts call for low returns for the next several years. As a result, the rationale for the current overweight is ~~a proxy~~ to serve as a ~~found~~ing source for other asset classes where a call down structure is used.

The RSIC's Core Fixed Income mandates have historically included primarily domestic government, agency, corporate, and asset-backed securities. The Staff will continue to evaluate the potential impact of managing a greater portion of these assets internally. Additionally, the Staff will continue to collaborate with the Consultant to monitor the existing managers, as well as to identify opportunities to improve the implementation of the asset class.

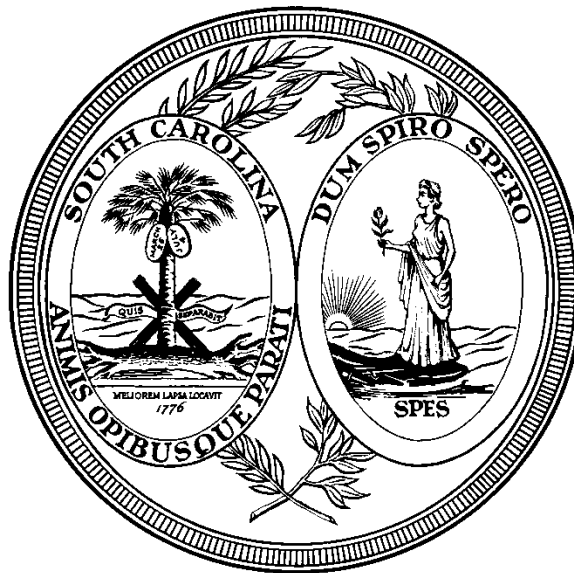
#### Global Fixed Income

The current allocation is 3.7% and will decline as capital is re-allocated to other asset classes. As with Core Fixed Income, Staff expects the asset class to serve a diversifying role in the overall portfolio. Staff will conduct a comprehensive review during the year.



**SOUTH CAROLINA RETIREMENT SYSTEM  
INVESTMENT COMMISSION**

**ANNUAL INVESTMENT PLAN  
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as adopted by the Retirement System Investment Commission  
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## SECTION 1: OVERVIEW AND PURPOSE

### Overview

Annually, the Commission adopts a Statement of Investment Objectives and Policies (“SIOP”), which provides the objectives, policies, and guidelines for investing the assets of the Retirement System. The SIOP provides the framework by which the RSIC, at the direction of the Chief Investment Officer (“CIO”), drafts a proposed Annual Investment Plan (“AIP”). South Carolina law requires the CIO to submit the proposed AIP to the Commission no later than April 1<sup>st</sup> of each year, and the Commission must adopt a final AIP no later than May 1<sup>st</sup> of each year for the following fiscal year which begins on July 1. The Commission may amend the AIP during the fiscal year as it deems appropriate.

### Purpose

The purpose of the AIP is to provide a formal document for investing and managing the Retirement System’s assets to achieve the Commission’s investment objectives and mission as stated in the SIOP, which is incorporated therein.

## SECTION 2: STRATEGIC INITIATIVES

It appears there is a change in presentation in this section as compared to the prior year. There is no presentation discussing the strategic initiatives from the prior year and what results have been achieved. This type of analysis should be included. Without a summary of what has been achieved for the prior year, it is not as readily apparent what points are still open. With current year language modification on current strategy it is not easy to identify what is a continuation versus what issues may have been resolved from the prior year. As an example, it cannot be readily identified if the prior year initiative of “Transition away from the Portable Alpha implementation” has been achieved.

Each year the Investment Staff undertakes initiatives approved by the Investment Commission within the AIP with the goal of improving capabilities and performance of the Plan. Staff will continue working on prior initiatives set by the Commission, which include:

- Implement the outcome of the RFPs for risk management, administrative services, and private markets systems.
- Continue to actively recruit for open positions and re-allocate existing positions as the organization’s needs evolve.
- Re-structure the Strategic Partnership model, designing a customized fund-of-one solution to be used with existing and new key partners for both traditional and alternative assets and investment strategies.
- Continue to rationalize the external manager allocations to achieve the most efficient portfolio implementation strategy.
- Grow the internal investment research function to serve as a key input for all investment decisions across the organization, focusing primarily on investment strategy, tactical asset allocation, and direct/co-investment opportunities.
- Concurrently evaluate the capacity to expand internal asset management, to include a due diligence assessment of our abilities by an external entity, as the systems and business infrastructure implementation is finalized.

- Continue to negotiate for lower fees and better terms with managers.

These initiatives may be amended based on the recommendations from the fiduciary audit by Funston, upon a majority vote by the Commission.

### SECTION 3: INVESTMENT STRATEGIES AND TRANSITION

Please clarify whether the percentages in these paragraphs are by asset allocation or by exposure. It appears the percentages are by asset allocation. In addition, please add a chart – providing a “snap shot” of the mix of the asset categories, percentages, and grand total.

#### Strategic Partnerships

The Commission has approved ~~several~~ fourteen Strategic Partnerships as of December 31, 2013, which are customized, flexible, and opportunistic investment mandates ~~implemented via separate corporate structures or legal entities~~ managed jointly by a general partner, RSIC as the limited partner without certain rights or privileges available to the general partner, and an external investment manager. Each Strategic Partnership has an Investment Committee overseeing its operations and investment mandate. The Investment Committee in each case consists of several members from the general partner as/or the external manager and either one or both of RSIC’s Chief Investment Officer and Deputy Chief Investment Officer as delegated by the Commission and as outlined within each Strategic Partnership agreement. The Strategic Partnerships follow a similar approval process for each investment, which requires that each new investment or investment strategy undergo due diligence by the investment manager and RSIC Staff, ~~be reviewed by the Commission’s consultant~~, be approved by the RSIC’s Internal Investment Committee, and then receive unanimous consent of the Strategic Partnership’s Investment Committee. ~~The Commission’s investment Consultant will be informed of the investment decisions within each Strategic Partnership, serve as a key input to the IIC, provide a prudence memo to the Commission as requested for individual investments and new investment strategies, and RSIC shall maintain due diligence records on each Strategic Partnership.~~ The governing body of each Strategic Partnership maintains and manages policies, procedures, and budgets for the respective entity and these documents shall be available on the secure Commission Watchdax server.

~~Staff will be implementing approved changes by the Commission and recommending additional changes to the Strategic Partnerships during fiscal year 2014.~~

#### Asset Class Policy Targets and Commentary

Staff, in conjunction with the Consultant, recommends no change to the Policy asset allocation for the fiscal year ending 2015. The recommendation to maintain a conservative asset and risk allocation is driven from analyzing the liabilities and the financial health of the Retirement Systems. We believe that the current Policy asset allocation will achieve the goals and objectives of the Commission over a long term horizon [will all reported percentages be based on actual allocation or allocation by exposure?]. Recommendations will be made to the Commission to amend the asset allocation as warranted. Over the shorter term, Staff will continue to monitor the economic environment and make asset allocation tilts within the portfolio, maintaining compliance with the SIOP.

The Investment Staff will seek to create a more efficient implementation within a number of asset classes, utilizing a combination of passive, active, enhanced, and hedged strategies. The goal of this review and future recommendations to the Commission will be to further enhance the risk-return ratio while still achieving growth, income and stability of the assets.

#### Global Equity

The Global Equity target asset allocation consists of 31% to publically traded securities and 9% to private equity, for a total of 40%.

#### Global Public Equity

Currently, the portfolio is diversified across the various regional components of the MSCI ACWI: United States, Developed World ex-United States, and Emerging Markets. The portfolio is managed to maintain similar weights of the regional components of the index. As a result, the United States has the largest allocation making up approximately 50% of the global public equity allocation, with Emerging Markets being the smallest at roughly 10% of the global public equity allocation. Within the United States, the portfolio has an overweight to small capitalization stocks, which traditionally have a higher beta to the Policy benchmark, the MSCI All Country World Index (“MSCI ACWI”).

For FY 2014-15, there will be a focus on transitioning the portfolio from specific regional components to a more global structure. In addition, Staff will be exploring enhanced index strategies as one area that will provide the flexibility of transitioning to a more global portfolio structure, while balancing passive and active strategies. Enhanced Index strategies tend to be low to modest tracking error strategies that are the result of small, factor-based deviations from an index. The result of this strategy can be a higher information ratio, which implies more consistency around generating excess returns.

Market exposure will continue to be maintained through allocating to managers as well as through the Overlay program. Staff expects to use a combination of active, passive, enhanced, and hedged strategies within this asset class.

#### Private Equity

Currently, there is a slight over allocation to private equity with current levels at 9.6% of plan assets. The pacing for the coming year is expected to be approximately \$300M.

For FY 2014-15, there will be a focus on making commitments to the Energy, Growth Equity, and Buyout segments of the asset class. Energy, in particular, presents multiple compelling long term opportunity sets.

In addition to fund commitments, staff is pursuing a variety of methods to execute on co-investment transactions. Co-investments are a way to invest in managers’ best ideas at favorable economics, and they are expected to generate excess returns. Currently, we are pursuing co-investment opportunities from Strategic Partners, but staff is also looking at additional opportunities from those managers who are not formal Strategic Partners.

#### Real Assets

Real Estate and Commodities are the components of the Real Assets policy allocation. Real Estate’s policy weight is 5% and Commodities’ remains at 3%. Staff will assess adding other investment strategies within this category, such as infrastructure.

#### Real Estate

As of February 2014, the Real Estate asset class is currently underweight at 3.9% of plan assets. This is primarily due to the call down nature of investing in private market strategies. The pacing schedule for FY 2015 is expected to be \$250 million. Staff anticipates committing a large portion of this allocation to

core real estate. Staff is working with several managers to determine the feasibility of a separate account structure to build this allocation over the next several years.

#### Commodities

As of February 2014, the Commodities allocation was approximately 2% of Plan assets, an underweight of 1%. As a result of hedge fund reclassifications and terminations, the Commodities allocation is now implemented entirely through the Overlay program, using swaps for passive benchmark and roll-select implementations. For FY 2014-15, Staff will seek to add trading strategies and explore merchant-based (hold physical positions) commodity investment strategies.

#### Diversified Credit

The Credit category is included in return-seeking assets with a target allocation of 18%. This category includes a 6% allocation to Mixed Credit, a 6% allocation to Emerging Markets Debt and a 7% allocation to Private Debt.

#### Mixed Credit

Mixed credit is made up a variety of non-core fixed income investments, including high yield bonds, bank loans, credit-oriented hedge funds, mortgages and asset backed securities. As of February 2014, the Mixed Credit allocation was 8.2%. While this is overweight the target allocation by 2.2%, this allocation will be reduced and brought back closer to Policy. Staff will review high yield bond and bank loan managers, and recommend changes, as warranted.

#### Emerging Market Debt

Emerging Market Debt has a policy target of 6% and is currently underweight at 4.1%. The asset class is divided into debt issued in US dollars and debt issued in each country's local currency. Staff will conduct new manager searches in this area.

#### Private Debt

The Private Debt asset class has a target allocation of 7% of total plan assets. Currently, that allocation is approximately 5.9%. For 2014-15, there will be a focus on commitments to Energy Debt opportunities (to complement the Energy Equity invested in the PE portfolio), Direct Lending, and Mezzanine investments. Distressed Debt generally has compelling opportunities despite the market cycle, and is usually industry and company specific.

#### Opportunistic

The Opportunistic asset class includes a dedicated Low Beta Hedge Fund allocation of 8%. The category is expected to improve diversification (i.e. decrease risk) of the Fund as a result of asymmetric performance – reasonable positive contributions to the Fund while avoiding significant drawdowns.

Hedge fund strategies can be implemented through the Low Beta Hedge Fund classification or through traditional asset classes. When hedge funds are utilized in a traditional asset class, its benchmark will be consistent with the asset class, and when classified as a Low Beta Hedge Fund, the benchmark is the HFRI Fund Weighted Composite Index. In total, Hedge funds have a maximum target of 15% of plan assets. As of May 1, 2014, hedge funds constitute \_\_\_\_ % of the Plan.

The Opportunistic asset class also includes a 10% allocation to Global Asset Allocation (GTAA/Risk Parity) strategies.

#### Hedge Funds

The current portfolio has hedge funds in three asset classes: Low Beta Hedge Funds, Global Public Equities and Mixed Credit. For FY 2014-15, Staff will continue to focus on optimizing the Low Beta Hedge Fund portfolio to reflect high conviction, market neutral strategies. The use of hedge funds in traditional asset classes will continue to be reviewed on a case-by-case basis to ensure that the structure of the investment is appropriate for a higher beta strategy.

#### Global Asset Allocation

This asset class has historically included both Global Tactical Asset Allocation and Risk Parity strategies. Approximately 35% of the exposure to the asset class is passive. During the year, Staff intends to evaluate new strategies with the expectation of converting the passive exposure to actively-managed, alpha-oriented strategies. Any new strategies will be funded through a reduction to the existing passive exposure.

#### Conservative Fixed Income

The Conservative Fixed Income asset class is intended to provide the primary source of diversification as a lower risk, liquid, short duration, and/or high credit quality component of the fund. The category is also managed as the primary source of capital to pay benefit obligations. Within the Conservative Fixed Income category, the Policy target allocations to Cash/Short Duration will be 5% in total, Core Fixed Income will remain at 7%, and Global Fixed Income remains at 3%.

Staff plans to initiate a broad, comprehensive review of its entire Conservative Fixed Income asset classes over the coming year [needs to be defined more specifically].

#### Core Fixed Income

The current allocation is 8.9%; however, this level is likely to decline as capital is shifted to other asset classes that are currently underweight. While there is a clear diversification benefit of the asset class, the current forecasts call for low returns for the next several years. As a result, the rationale for the current overweight is a proxy for other asset classes where a call down structure is used.

The RSIC's Core Fixed Income mandates have historically included primarily domestic government, agency, corporate, and asset-backed securities [of what investment grade/rating]. The Staff will continue to evaluate the potential impact of managing a greater portion of these assets internally. Additionally, the Staff will continue to collaborate with the Consultant to monitor the existing managers, as well as to identify opportunities to improve the implementation of the asset class [needs to be defined more specifically].

#### Global Fixed Income

The current allocation is 3.7% and will decline as capital is re-allocated to other asset classes. As with Core Fixed Income, Staff expects the asset class to serve a diversifying role in the overall portfolio. Staff will conduct a comprehensive review during the year [needs to be defined more specifically].



EDWARD N. GIOBBE  
VICE CHAIRMAN

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COMMISSIONER

REBECCA M. GUNNLAUGSSON, PH.D  
COMMISSIONER

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COMMISSIONER

HERSHEL HARPER, JR., CFA  
CHIEF INVESTMENT OFFICER

W. GREG RYBERG  
CHIEF OPERATING OFFICER

May 1, 2014

To: The South Carolina Retirement System Investment Commission ("RSIC" or "Commission")

From: Hershel Harper, CFA, CIO  
RSIC Internal Investment Committee ("IIC")

RE: Recommendation Regarding PENN Short Duration High Yield

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**Summary:**

Firm	PENN Capital Management, Inc. ("PENN")
Strategy	Short Duration High Yield
RSIC Investment	\$247 million as of 2/28/14
Proposed Management Fee	Tiered: 0.40% - \$0 to \$150 million; 0.37% - +\$150million to \$200 million; 0.35% - +\$200 million (currently 0.40%)
Liquidity	Weekly
Renewal Date	November 1, 2016

**Motion:** The Investment Team recommends that the Commission separate the investment management contract for the PENN Opportunistic High Yield and PENN Short Duration High Yield Strategies. The Investment Team also recommends extending the contract for PENN Short Duration High Yield for additional two and a half years, in order to match the expiration of the PENN Opportunistic High Yield contract.

**Purpose:** If approved, this recommendation allows RSIC the ability to bifurcate the two different strategies into separate and distinct investment contracts. It also affords RSIC flexibility with respect to the implementation of the Plan's 3% allocation to Short Duration strategies as well as the ability to reduce the portfolio duration across the Plan's High Yield exposures.

**Background:** Currently, RSIC has two strategies with PENN: Opportunistic High Yield and Short Duration High Yield. The strategies differ in the duration and maturity of the underlying investments, but otherwise rely on the same underwriting and investment process in which each underlying investment is subject to the same disciplined approach of fundamental bottom-up research, liquidity analysis, and qualitative research to mitigate downside risk.

**Investment Structure:** The PENN Short Duration High Yield account is structured as a Separately Managed Account (SMA) and the assets are held in custody at BNY Mellon.

**Investment Objective:** The objective of the Short Duration High Yield strategy is to preserve investor capital while managing duration and generating current income from U.S based, U.S. dollar denominated corporate debt. The Short Duration High Yield strategy focuses on a portfolio of short-term, low volatility high yield debt with an expected maturity of approximately 12-24 months and a final maturity not to exceed three years. Investments in the portfolio look to capitalize on short duration paper that is likely to be re-financed or retired and includes floating rate loans and corporate fixed-income bonds. The Short Duration strategy generally will have a B+ average credit quality and will have a truncated downside risk due to the short expected average life of the portfolio.

**Investment Update:** In the initial negotiation of PENN's contract renewal, PENN has agreed to further revise its fee schedules for both the Opportunistic High Yield and Short Duration High Yield strategies. The fee schedules are now tiered structures providing for reduced fees based on RSIC's commitment in each strategy. Below are PENN's proposed fee structures:

Opportunistic High Yield		Short Duration High Yield	
<b>Current Fee Structure</b>		<b>Current Fee Structure</b>	
52bps	-> Flat fee	40bps	-> Flat fee
<b>Revised Fee Structure</b>		<b>Revised Fee Structure</b>	
50bps	-> \$0 to \$100mm	40bps	-> \$0 to \$150mm
45bps	-> +\$100mm to \$230mm	37bps	-> +\$150mm to \$200mm
35bps	-> +\$230mm	35bps	-> +\$200mm

**Performance:** Since Inception (February 2012), the PENN Short Duration High Yield strategy has a cumulative return of 10.07%. The strategy is part of RSIC's "Short Duration" asset class which is benchmarked against the Barclays 1-3 year Government/Credit Index.

Total Returns - as of 2/28/14			
	1 Year	2 Years	SI
PENN Short Duration HY <sup>1</sup>	4.79%	4.57%	4.71%
Barclays 1-3 yr Gov/Credit	0.81%	0.94%	0.90%
Barclays US High Yield	8.38%	10.09%	10.91%

<sup>1</sup> BNY Gross Returns

**Investment Process & Risk Control:** The investment philosophy and process for PENN's Short Duration strategy mirror those of its Opportunistic High Yield strategy. The firm's core business is its fundamental, bottom-up research and portfolio management. PENN applies a fully-integrated credit and equity research process that provides its team with a unique advantage when analyzing a company. Understanding a firm's complete capital structure and understanding the equity and debt metrics (and how they are related) provides multiple analytical tools to help in the underwriting process. PENN differentiates itself from competitors due to the collaborative approach of its equity and credit teams, which gives all parties a more robust understanding of every potential investment.

At PENN, a Credit Strategy Committee determines top down positioning in terms of industry and credit quality and is tasked with the ultimate decision-making authority on approving individual credits for the portfolio. A portfolio manager ("PM") is assigned to each strategy and is a member of the Credit Strategy Committee. The PM is responsible for leading the style discussions through the Credit Strategy Committee process. The PM is also responsible for monitoring the portfolio daily, while working closely with the analysts and is responsible for the buy and sell decisions for individual client portfolios.

**Turnover/Key Man Risk:** There has not been any turnover among the senior members of the team that manages the Short Duration High Yield strategy. Penn has an experienced team that provides analysis, expertise, and on-going surveillance of all positions. This is a 26 member team comprised of 11 portfolio managers, 8 analysts, and 9 traders.

**Authors:**

Geoff Berg, CFA, Managing Director  
Mike Addy, Senior Fixed Income Officer  
Nicole Waites, Fixed Income Analyst  
("Investment Team")

**To: Members of the Commission**

**From: Planning Committee**

**Date: April 29, 2014**

**Re: Report for May 1, 2014 Commission Meeting**

The Planning Committee was formed at the March Commission meeting and is comprised of Dr. Gunnlaugsson, Mr. Williams, and Dr. Wilder. The Committee has held meetings on April 1<sup>st</sup>, April 23<sup>rd</sup>, and April 29<sup>th</sup>, 2014. Dr. Gunnlaugsson was elected as the chairperson. Information related to the Committee has been posted to the RSIC website, in accordance with Commission policy.

The Committee reviewed Funston's Draft Final Report and strategic planning documents from the Commission's March meeting. The following items have been identified as key areas of strategic focus.

- 1) \*Shift Commission emphasis to providing oversight and strategic guidance.  
(Recommendations: G10.1, G10.3, G12.2, I2, I5.1, P1.1-P1.3)
- 2) \*Develop Human Resources functionality.  
(Recommendations: G15.1, G15.2, O3.1-O3.6, P4.1, P4.2)
- 3) Clarify and redefine the purpose, policies, and procedures of the IIC.  
(Recommendations: G16.1-G16.4, I3.3, I5.3)
- 4) Build infrastructure before expanding internal trading program, including 3<sup>rd</sup> party administrator implementation, operational policy development, and business case for expanded internal trading.  
(Recommendations: I4.1, I9.1)
- 5) Build out Investment Risk Management Function, including systems, integration with IIC, policies, procedures, and plans.  
(Recommendations: I3.1-I3.4, I4.2)
- 6) \*Develop and integrate legal investment function.  
(Recommendations: I6.1-I6.3, L1.1-L5.3)
- 7) Redefine and implement Communications Plan, including improving stakeholder interaction and leading industry-wide initiatives.  
(Recommendations: G18.1-G18.3)
- 8) \*Appoint Executive Director, accountable to Commission for managing entire organization.  
(Recommendations: G4, O1.1)

- 9) Build out IT functionality, including personnel and strategic plan.

*(Recommendations: IT1.1-IT4.2)*

- 10) Continue to develop Enterprise Risk Management Function.

*(Recommendations: G13.2, G13.3, L4.4)*

Four of strategic priorities have status updates and/or action items. Additionally, these areas were incorporated into the AIP.

- 1) Shift Commission emphasis to providing oversight and strategic guidance.
  - a. Planning Committee, working in conjunction with the CIO, has developed a draft Statement of Investment Principles to guide the asset allocation and oversee the development of asset class plans. This is to be reviewed by the full Commission, with feedback provided by May 15<sup>th</sup>, to finalize for adoption at the June Commission meeting. *Motion to be presented.*
  - b. Planning Committee recommends the Commission (i) eliminate the practice of Commissioner participation in investment manager due diligence except for educational purposes and (ii) discontinue the informal use of asset class assignments for Commissioners and (iii) formalize the agenda-setting process already in place. *Motion to be presented.*
- 2) Develop Human Resources functionality.
  - a. HR Director position has been posted.
  - b. Additional oversight is requested in the proposed amendment to Comp. Committee Charter, which includes shifting emphasis of Compensation Committee to encompass HR by modifying charter and name; and annually reviewing PIC plan [To be presented by the Comp. Committee.]
- 6) Develop and integrate legal investment function.
  - a. Planning Committee recommends that the Commission repeal the Motion approved July 19, 2012, which stated: “the Commission would not move to a final investment contract unless each Commissioner has a minimum of 30 days to look at all final documents” to apply to all pending and future investments, including renewals. *Motion to be presented.*
- 8) Appoint Executive Director, accountable to Commission for managing entire organization.
  - a. Planning Committee recommends modifications to Governance Policies to support the new role of Executive Director. *Motion to be presented.*

Next steps will include the development of a formalized workplan to complete the recommendations of the Funston report, similar to the dashboard developed in response to the 2011 Deloitte report. The Planning Committee will analyze status and provide quarterly updates to the Commission.

## **RSIC Investment Principles**

The Commission establishes and adopts the following fundamental principles as the foundation for the management of Plan assets:

1. Organizational and portfolio structure should always be managed prudently for the benefit of all Plan participants and their survivors.
2. Human, technology, and financial resources should be managed to reflect the highest and best use of both internal and external resources consistent with the constraints inherent to the Plan. Intellectual capital is a core element of the process, as it is highly valued as the most significant source of value and performance, and should be developed and retained in order to be successful.
3. The investment strategy must incorporate the combination of the structure of the Plan's liabilities, risk profile and assets. Accordingly, preservation of capital, income generation, and capital appreciation are the three equally important but competing demands on the assets of the Plan. The provision of sufficient liquidity to pay benefits is the ultimate constraint governing risk management of the Plan.
4. Asset allocation is the dominating determinant of performance variance over the long term investment horizon. Taking risk is required to achieve the goals of the Plan; therefore, the Plan may periodically experience negative returns. Diversification across and within asset classes can spread the volatility of economic outcomes, reducing the adverse effects of most negative market environments.
5. Markets are cyclical, creating variability of returns. A sound and flexible research-oriented investment strategy is required to potentially capture higher risk adjusted returns over time.
6. A global, opportunistic approach to dislocated markets, special situations, and/or stressed assets is consistent with the long time horizon of the Plan, so it can be prudent to allocate a portion of the Plan to illiquid investments.

7. An entrepreneurial mindset is necessary to support and encourage an opportunistic approach to capital markets, as is a properly aligned organizational structure, culture, and operational capacity. Cultivating partnerships with like-minded investors is critical to implementing this investment strategy.
8. A policy of open engagement is the best approach for constructive dialogue with broader stakeholders and interested parties.

## **Policy IV : Commission Operations**

### **(A) General Operations**

- (1) The Commission will take the following under consideration for approval:
  - (a) The basic organizational structure of the RSIC.
  - (b) The Commission will approve the general processes to be used to establish the strategic and/or business plans, and operational budgets of the RSIC.
  - (c) Based on the recommendations from of the Chief Investment Officer (“CIO”) and Chief Operating Officer (“COO”) for:, the Commission will approve:
    - (i) Business and strategic plans
    - (ii) Annual operating budget request
- (2) The Commission will ensure that an effective process of enterprise risk management is in place.
- (3) After review of the recommendations by the CIO and COO, the Commission will discuss the recommendations and approve an Operating Budget for the RSIC.

### **(B) Officer Elections Process**

#### **(1) Chairman; Vice Chairman**

- (a) The Officers of the Commission shall be a Chairman and a Vice Chairman, each of whom shall serve a two-year term ending June 30 of even numbered years. The Vice-Chairman shall act as Chairman during the Chairman’s temporary absence or other inability to serve. In the event of the Chairman’s permanent absence, the Vice Chairman will serve for the remainder of the Chairman’s term.
- (b) Nominations.** The Chairman shall accept all nominations from voting members for the election of the successor Vice-Chairman.
- (c) The Commission shall select a successor Vice Chairman in the event of removal, resignation, or other reason for which the Vice Chairman is unable to complete his or her term. The elected successor will serve the remaining portion of the previous Vice Chairman’s term in accordance with section (a) above.
- (d) The State Treasurer may not serve as Chairman or Vice Chairman of the Commission.
- (e) The Chairman and Vice Chairman will serve until his or her successor is duly elected or until he or she resigns, is unable to serve, or is removed from office, whichever comes first.
- (f) The Commission may select other officers it determines necessary.

#### **(2) Retiree Representative Member**

- (a) The voting members of the Commission will appoint the Retiree Representative Member by unanimous vote. [\(§9-16-315\(A\)\(6\)\)](#)
- (b) The Retiree Representative Member will serve for a term of five years and until a successor is appointed and qualified. The Retiree Representative Member’s term will be deemed to expire after June 30th of the year in which the term expires. [\(§9-16-315\(C\)\)](#)
- (c) By law, the Retiree Representative Member must be a retired member of the Retirement System and possess the qualifications required by [§9-16-315](#). For qualifications, see *Commission Roles and Responsibilities Policy*.
- (d) **Nominations.** During the year in which the incumbent Retiree Representative Member’s term expires or in the event of a vacancy for any reason:



- (i) Commission members and associations that represent stakeholders may present nominations for Retiree Representative Member;
- (ii) The Commission will provide notice of the pending vacancy of the Retiree Representative Member at least one meetings prior to the expiration of the term in its regularly scheduled meeting agenda. If a Retiree Representative Member does not complete his or her term for any reason, the Commission will ensure the vacancy is announced at least one meeting prior to appointing a new Retiree Representative Member;
- (iii) If nominations are received which meet the statutory requirements, nominees may be invited to meet with the Commission; and
- (iv) The voting Commission members will endeavor to conclude the nomination process and appoint a Retiree Representative Member prior to June 30 of the year in which the incumbent's term is to expire. In the event of a vacancy for some other reason, the voting Commission members will endeavor to conclude the nomination process and appoint a Retiree Representative Member as soon as practicable.
- (e) The Retiree Representative Member will serve until (i) his or her successor is duly elected and qualified or (ii) he or she resigns, is removed from office, or is otherwise unable to complete his or her term, whichever comes first.

**(C) Special Elections and Removal of a Commission Officer**

- (1) If appropriate, the Commission may commence a special election to fill any vacancies of officers or the Retiree Representative Member occurring outside the scope of other policies.
- (2) In the event a Commission member finds removal of a Commission Officer, including but not limited to, Chairman, Vice Chairman, or a Committee Chair, from his office is appropriate, he must communicate reasons supporting removal from office to the Commission.
- (3) After receiving information regarding the potential removal of a Commission Officer, the voting Commission members will vote on whether removal from office is appropriate.
- (4) In compliance with law, only the Governor may remove a Commission member from the Commission and only for reasons stated in S.C. Code Ann. §1-3-240(C). *See Commission Roles and Responsibilities Policy*

**(D) Education**

**(1) Overview and Continuing Education**

- (a) In order to help fulfill their fiduciary duties, Commissioners should continually develop and maintain their knowledge of pension investment and administration matters by attending educational presentations and events, ~~and may perform due diligence regarding issues such as investment manager selection and custodial bank selection.~~
- (b) Commissioners should report all continuing education related to the Commission to the Chairman or COO.
- (c) Commissioners are encouraged to participate in at least 16 hours of continuing education annually, including in-house seminars, pertinent national conferences, select investment and pension plan administration courses, and continuing educational courses offered through local colleges and universities.

**(2) Commissioner Orientation**

- (a) New Commissioners must attend an investment and administration orientation provided by RSIC management and staff within sixty days of becoming a Commissioner.
- (b) The orientation will include, but is not limited to:
  - (i) CIO and COO briefing on the history and background of RSIC and instructions regarding accessing the RSIC's secure website;
  - (ii) A briefing by the Commission Chairman on current issues before the Commission and backgrounds of other Commissioners;
  - (iii) Introduction to staff members;
  - (iv) A tour of RSIC's offices;
  - (v) A briefing by RSIC legal counsel on Commissioner fiduciary duty, conflicts of interest guidelines, state ethics, and other pertinent laws affecting RSIC; and
  - (vi) Distribution and review of copies of the RSIC policies, including governance policies, the Annual Investment Plan, Personnel Handbook, a copy of the CFA Institute's Code of Conduct for Members of a Pension Scheme Governing Body, and any other relevant information deemed appropriate by the Chairman, CIO, or COO.
- (c) New Commissioners are encouraged to attend at least one conference or seminar relating to pension fund investments within his or her first year as a Commissioner.
- ~~(c)~~(d) For educational purposes, new Commissioners are required to participate in the due diligence of an investment manager, alongside staff, during his or her first two years as a Commissioner.

**(E) Travel**

- (1) Commissioners must exercise the same care in incurring expenses that a prudent person would exercise if traveling on personal business and spending personal funds.
- (2) All Commissioners' travel must comply with RSIC's *Travel Policy* and the *Comptroller General's Policy on Reimbursement for Travel and Subsistence Expenses*.
- (3) Travel must pertain to RSIC business and enhance the knowledge and capabilities of the Commissioner relevant to his or her duties relating to the RSIC.
- (4) Commissioners may provide copies of conference material to the COO which may be distributed to other Commissioners and/or RSIC staff.

**(F) Meeting Policies**

- (1) Regular meetings will be held at least once during each fiscal quarter and at other times as set by the Commission or Chairman or requested by the Budget and Control Board. (§9-16-320(B))
- (2) The annual schedule may be modified by the Commission as necessary, and timely notice of such changes must be provided as appropriate in accordance with the South Carolina Freedom of Information Act ("FOIA").
- (3) The Chairman or a majority of the Commission may call a special meeting or cancel regular meetings, so long as notice is provided as appropriate in accordance with the FOIA.
- (4) In providing timely notice of a meeting to the public, the Commission will post notice within a reasonable time not less than 24 hours prior to the meeting on the RSIC's website and at RSIC's office. (§30-4-80)

- (5) As defined by South Carolina law, a “meeting” for purposes of the FOIA means the convening of a quorum of the constituent membership of a public body, whether corporal or by means of electronic equipment, to discuss or act upon a matter over which the public body has supervision, control, jurisdiction or advisory power. (§30-4-20(d)). Every meeting of all the Commission shall be open to the public unless closed pursuant to S.C. Code Ann. §30-4-70.
- (6) Conference telephones or similar equipment may be used whenever the Commission meets, including executive session meetings as authorized by law. Commissioners may use conference telephones or similar communications equipment by means of which all members and other persons duly participating in the meeting can hear each other. Participation in a meeting pursuant to this policy will constitute presence for purposes of convening a quorum of the Commission. In the event of a telephone conference call, members of the public will be permitted to observe.(§30-4-20(d))
- (7) No chance meeting, social meeting, or electronic communication may be used in circumvention of the spirit of FOIA requirements related to matters of the Commission. ([§30-4-70\(c\)](#))

#### **(G) Rules of Order**

##### **(1) General**

- (a) The Commission and its Committees will follow as closely as practicable the rules of order prescribed for small assemblies or similar small bodies in the most recently published revision of Robert’s Rules of Order in conducting its meetings, to the extent not suspended or modified by the Commission’s policies or agreed upon practices.
- (b) The Chairman will be counted to establish quorum at meetings.
- (c) Such rules of order will be construed to promote the orderly and efficient conduct of business and to avoid procedural complexity which may delay or hinder the taking of action required by law or advisable in the prudent exercise of the Commission’s fiduciary responsibilities.

##### **(2) Order of Business-Meeting Agenda Format**

- (a) The order of business is the established sequence in which business will be taken up at a Commission meeting.
- (b) The order of business will be at the discretion of the Chairman in consultation with the Commission, but will normally be as follows:
  - (i) Call to Order
  - (ii) Approval of Meeting Agenda
  - (iii) Approval of previous Commission meeting minutes
  - (iv) Reports from Officers and/or Committees
  - (v) Investment Items
  - (vi) Administrative Items
  - (vii) Other Business
  - (viii) Adjournment
- (c) The Commission may rearrange the normal Order of Business outlined above by majority vote of the voting members of the Commission; however, no item which binds the Commission to action may be added to the agenda which has been posted pursuant to FOIA.

##### **(3) Agenda Items and Procedure**

- (a) Draft proposed meeting agendas will be set by the Chairman, in consultation with Staff and Commissioners.
- (b) Once set as described above, the draft proposed agenda will be distributed to the Commissioners.
- (c) Commissioners may request to have items introduced for the Commission's consideration by submitting the request or a proposed motion ("Main Motion") in writing to the Commissioners and appropriate staff member(s) at least three days prior to the meeting.
- (d) Amendments to draft proposed agenda items, requested by a Commissioner in writing more than three days prior to meeting, will be made at the Chairman's discretion. The updated proposed agenda will be distributed not less than 24 hours prior to the meeting's scheduled commencement.
- ~~(b)~~(e) Amendments to a draft proposed Main Motion, sought by a Commissioner less than three days prior to a meeting, should be submitted in writing at the meeting.
- ~~(c)~~(f) Motions which change or affect how a Main Motion is addressed by the Commission ("Subsidiary Motions") may be made as information is presented and discussions ensue and are not required to be submitted in writing in the same manner as Main Motions.
- ~~(d)~~(g) In accordance with state law, the Commission will not address business that has not been included in the meeting notice that binds the Commission of expenditure of funds except as provided by law.

#### **(H) Meeting Minutes**

- (1) Minutes of Commission meetings will be taken in accordance with state law and such records are open to public inspection.
  - (a) The COO will cause the minutes of all Commission meetings to be prepared, recording therein the time and place of each meeting, the names of the members present, and a summary of the actions of the Commission including: abstentions from voting and the reason for the abstention, the affirmative and dissenting votes, except where the action is unanimous, and when requested, a Commissioner's dissent or approval with reasons.
  - (b) The COO will cause the minutes to be presented for approval at the next regular Commission meeting.
- (2) Meetings during executive session are not subject to the above requirements. (§9-16-320(D))
- (3) Commission minutes will focus on describing any actions that occurred, and will provide sufficient detail to evidence the Commission's due diligence in the matter.
- (4) The minutes of a meeting during which an executive session is held will reflect the topic of the discussion at the executive session.
- (5) If the Commission votes during executive session, RSIC will publish actions in a subsequent meeting when appropriate or otherwise make such information available to the public as applicable.
- (6) The minutes as approved by the Commission, will be preserved as a part of the official public record of the Commission, and will be kept open to public inspection in accordance with law.
- (7) A record of the Commission or its fiduciary agents that discloses deliberations about, or a tentative or final decision on, investments or other financial matters is exempt from the

disclosure requirements of Chapter 4 of Title 30, the Freedom of Information Act, to the extent and so long as its disclosure would jeopardize the ability to implement an investment decision or program or to achieve investment objectives. (§9-16-80(B))

**(I) Executive Session**

- (1) The Commission may conduct business in executive session, which will be closed to the public, under the following conditions:
  - (a) The executive session is held during a regular or special meeting of the Commission;
  - (b) The Commission announces to the public present at the meeting the topic of the discussion;
  - (c) The executive session is held for the purpose of considering any matter enumerated in S.C. Code of Law Ann. §§9-16-80(A), 9-16-320(C), 30-4-70, or in accordance with any applicable law, including but not limited to:
    - (i) Meetings of the Commission, or by its fiduciary agents, to deliberate about, or make tentative or final decisions on, investments or other financial matters if the disclosure of such deliberations or decisions would jeopardize the ability to implement a decision or to achieve investment objectives.
    - (ii) Discussion of employment, appointment, compensation, promotion, demotion, discipline, or release of an employee, or a person regulated by a public body or the appointment of a person to a public body.
    - (iii) The receipt of legal advice where the legal advice relates to a pending, threatened, or potential claim or other matters covered by the attorney-client privilege, settlement of legal claims, or the position of the public agency in other adversary situations involving the assertion against the agency of a claim.
- (2) When executive session has commenced, only the following persons may be present:
  - (a) Members of the Commission;
  - (b) Staff members of the RSIC requested by the Commission, who may provide information or advice relating to the purpose(s) for which the body has convened in executive session; and
  - (c) Others requested and approved by a majority of the voting members of the Commission, for the purposes of providing information or advice relating to the matter(s) for which the body has convened in executive session.
- (3) Notwithstanding section I(2) above, the Commission must unanimously approve the attendance of any person other than RSIC legal counsel during an executive session or portion of an executive session relating to items described in I(1)(c)(iii) above.
- (4) Fiduciaries and employees of fiduciaries are prohibited from, during or after their term of service, disclosing or using confidential information acquired in their official capacity as fiduciary or employee of the fiduciary, without proper authorization. [§9-16-360\(7\)](#)

**(J) Quorum**

- (1) A quorum of at least four voting members must be present for the Commission to convene a meeting or to conduct business.
- (2) The act of the majority of voting members present and voting at a meeting at which a quorum is present will constitute official action of the Commission.
- (3) Any member of the Commission who would be required to vote on a matter that would result in a conflict of interest must abstain from voting, refrain from participating in any

discussions pertaining to the matter, and prior to the vote being taken, explain the conflict and disclose the nature of his or her interest for Commission records. The COO shall cause this information to be placed into the meeting minutes. For more information on standards of conduct for Commissioners, see *Commission Roles and Responsibilities Policy*.

**(K) Gender References, Policy Review & History**

- (1) Any gender-specific language in this policy shall include the other gender.
- (2) The Commission will review this policy at least every three years to ensure that it remains relevant and appropriate, or when there is an amendment to applicable law relevant to any section of this policy, or when there is a Commission approved change in the responsibilities, duties, or operations of the Commission or its Committees generally.
- (3) No provision of this policy shall apply to the extent that it is in conflict with any provision of the Code of Laws of South Carolina, 1976, as amended. In the event of such conflict, the applicable Code provision shall apply in all respects.
- (4) This policy was adopted on November 19, 2009.
- (5) This policy was amended on November 17, 2011.
- (6) This policy was amended on November 8, 2012.
- [\(7\)](#) This policy was ~~last~~ amended on February 28, 2013.
- [\(7\)\(8\) This policy was last amended on DATE.](#)



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VICE CHAIRMAN

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COMMISSIONER

REBECCA M. GUNNLAUGSSON, Ph.D  
COMMISSIONER

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**RETIREMENT SYSTEM INVESTMENT COMMISSION**  
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W. GREG RYBERG  
CHIEF OPERATING OFFICER

April 29, 2014

To: Rebecca M. Gunnlaugsson, Ph.D  
Chair, Ad Hoc Planning Committee

The Honorable W. Greg Ryberg  
Chief Operating Officer

From: Robert D. Feinstein   
Chief Legal Officer

Re: RSIC Senior Management Structure – Legal Framework Considerations

On Monday, April 28, 2014, members of RSIC Legal were asked by you to provide guidance regarding the following issues:

1. Under current State law, what roles, responsibilities and functions must be performed by or have been delegated to the Chief Investment Officer (“CIO”);
2. Under current State law, what roles, responsibilities and functions must be discharged by the South Carolina Retirement System Investment Commission (“Commission”) with regard to the CIO; and
3. Under current State law, what roles, responsibilities and functions could be performed by or delegated to an Executive Director (“ED”).

The following analysis and conclusions are based solely on (i) an examination of existing State law (principally Title 9 of the S.C. Code) and (ii) verbal summaries that have been provided to me regarding the job duties of the ED and CIO, as the same might be allocated under an arrangement whereby (A) an ED would be the sole, “solid line” report to the Commission, (B) the CIO and a Chief Operating Officer would be solid line, direct reports to the ED, and (C) the CIO would have a “dotted line” reporting relationship with the Commission. Unless otherwise indicated, we have not considered other documents which govern or otherwise inform the Commission’s performance of its roles, responsibilities and functions, including (i) the Statement of Investment Objectives and Policies, (ii) the Governance Policies, or (iii) the Compensation Policy.

## ANALYSIS

An appropriate point of departure for this analysis is Section 9-16-10(4), which defines the term “fiduciary” as “a person who: (a) exercises any authority to invest or manage the assets of a system; .... (c) is a member of the commission; or (d) is the commission’s chief investment officer.”

Section 9-16-10(4)(a), (c) and (d). It is interesting to note that several members of RSIC staff, including the ED position outlined by you, would be covered by the first component of this definition, while the CIO is separately and explicitly named as a fiduciary in the fourth component of the definition.

While other provisions of Title 9 apply to all RSIC ‘Staff – fiduciaries’, the statutory framework makes clear that (a) the CIO position is unlike that of any member of RSIC Staff, (b) there are two main statutory roles, responsibilities and functions which must be performed by or have been delegated to the Chief Investment Officer, and (c) there are four main statutory roles, responsibilities and functions which should be discharged by the Commission with regard to the CIO.

A. Roles, responsibilities and functions which must be performed by or have been delegated to the Chief Investment Officer.

Unlike its treatment of any other member of RSIC Staff, State law requires the CIO to perform two main roles, responsibilities and functions: (1) developing and maintaining the Annual Investment Plan (“AIP”) and (2) investing and overseeing the investment of the SCRS trust funds. The key statutory provision is Section 9-16-315(G), which provides, in relevant part, that “[t]o assist the commission in its investment function, *it shall employ a chief investment officer, who under the direction and supervision of the commission, and as its agent, shall [(1)] develop and maintain annual investment plans and [(2)] invest and oversee the investment of retirement system funds*” (emphasis added).

Other provisions of Title 9 of the S.C. Code elaborate upon this statutorily specified allocation of duties. As to the investment of the SCRS trust funds’ assets, Section 9-16-340(A) states that the Commission, “acting through the chief investment officer, shall invest and reinvest the assets of the retirement systems as provided in Section 9-1-1310.”

With regard to the preparation, review and implementation of the AIP, there are at least three other provisions of State law which reinforce the statutorily specified connection between the Commission and CIO. Section 9-16-320 (A) provides that “[t]he annual investment plan must be developed by the Chief Investment Officer”, while Section 9-16-340(B) states that “[a]fter receiving the proposed [AIP] of the chief investment officer, the commission shall adopt an annual investment plan, which must be implemented by the commission through the chief investment officer.” See also Section 9-16-330 (C) (responsibilities of CIO in developing AIP).

B. Under current State law, what roles, responsibilities and functions must be discharged by the Commission with regard to the CIO?

While Section C of this memorandum identifies areas where an ED could be given significant roles, responsibilities and functions bearing on the following, it is first appropriate to note that current State law identifies four main roles, responsibilities and functions that the Commission must discharge with regard to the CIO.



1. Hiring of the CIO – The language of Section 9-16-315(G) – “*it shall employ a chief investment officer*” – suggests that, under existing law, the Commission should continue to play the final, decision-making role with regard to the hiring of the CIO.
2. Termination of the CIO - The language of Section 9-16-315(G) – “*it shall employ a chief investment officer*” – similarly suggests that, under existing law, the Commission should continue to play the final, decision-making role with regard to any involuntary separation from employment of the CIO.
3. Evaluation of the CIO – The language of Section 9-16-315(G) – “*it shall employ a chief investment officer, who under the direction and supervision of the commission*” – suggests that the Commission should continue to play the central role in evaluating the CIO’s performance. See also item B.4. (directly below).
4. Compensation of the CIO – Another provision of Section 9-16-315(G) notes that “[t]he chief investment officer serves at the pleasure of the commission and must receive the compensation the commission determines appropriate.” The question of the extent to which the Commission could or should delegate its authority to set the compensation of the CIO to a Commission committee and/or the ED is beyond the scope of this memo. It should be noted, however, that given the close linkage of the current EPMS evaluation process (item B.3 above) and the compensation-setting process spelled out in the Compensation Policy, a careful review of the relevant policies and procedures is strongly recommended before material changes are made.

Title 9 contains at least two other roles, responsibilities and functions that the Commission must discharge with regard to the CIO. Section 9-16-330(A) provides that:

1. the Commission is required annually to provide the CIO with the SIOP (referred to in 9-16-330 (A) as “a statement of general investment objectives”).
2. the Commission is required to provide the CIO with “a statement of actuarial assumptions developed by the system’s actuary and approved by the board.”

C. Under current State law, what roles, responsibilities and functions could be performed by or delegated to an Executive Director (“ED”)?

Based on the information which you have supplied, it would appear that there are a number of areas where, consistent with State law, an ED could be delegated significant roles, responsibilities and functions with regard to the CIO.

1. Hiring of the CIO - The ED could play a very active role in leading CIO recruitments, including the screening of applicants based on criteria and other directions received from the Commission.

2. Termination of the CIO - The ED could be empowered to perform some or all of the following functions: (i) apprising the Commission of issues or concerns relating to the CIO<sup>1</sup>, (ii) assisting the Commission in making decisions with regard to any involuntary separation from employment of the CIO, (iii) communicating the Commission's decision, if desired, and (iv) overseeing the implementation of any separation from employment.
3. Evaluation of the CIO – The ED could provide an input to the evaluation process and coordinate the evaluation process specified in the Governance Policies.
4. Compensation of the CIO – The ED could be delegated responsibility for coordinating the annual process presently followed to establish or fix the compensation of the CIO. To the extent that qualitative factors are included in determining the CIO's compensation, the ED could provide an input to the compensation-setting process. As noted above, however, given the close linkage of the current EPMS evaluation process (item B.3 above) and the compensation-setting process spelled out in the Compensation Policy, a careful review of the relevant policies and procedures is strongly recommended before such delegations or other changes are made.

Two concluding notes are warranted. First, based on the information you provided, it appears that the CIO will have a “dotted line” reporting relationship to the Commission. In light of the foregoing analysis, a “dotted line” reporting relationship would appear to be the irreducible minimum for purposes of satisfying the requirements and expectations inherent in the existing legal framework. Second, while it was not explicitly included in the questions you posed, based on the information provided, we would assume that the Commission plans to be responsible for the hiring, termination and evaluation of the ED, as well as setting the ED's compensation.

Please let me know if you have any questions or would like to discuss the matters addressed in this memorandum.

#### **ADVICE OF COUNSEL – NOT AN OPINION OF THE ATTORNEY GENERAL**

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<sup>1</sup> Likely an obligation of a fiduciary.

**Policy III : Executive Director, Chief Investment Officer and Chief Operating Officer**  
**Roles and Responsibilities**

**(A) Executive Director Role**

- (1) Serves as the agency head of the RSIC, reporting directly to the Commission, with functions and duties as assigned by the Commission.
- (2) The Executive Director is a fiduciary who must discharge duties consistent with fiduciary standards at all times.
- (3) The Executive Director is an at-will employee, selected by the Commission to oversee the Chief Operating Officer, Chief Legal Officer, HR Director, and Chief Investment Officer as specified within this Policy and as required by the Commission and state law.
- (4) The Executive Director is the central source of authority and accountability for administrative decisions.
- (5) The Executive Director helps to set the “tone at the top” regarding ethics and the culture of the RSIC.

**(B) Executive Director Responsibilities: General**

- (1) In consultation with the CIO and COO, develop and recommend to the Commission appropriate strategic direction, strategic plans, operating budget, internal controls, and risk parameters. Provide executive leadership in achieving the RSIC’s mission, goals and objectives, and the RSIC’s strategic plan, and ensure that they are developed, monitored, implemented, and reviewed at least annually by the Commission.
- (2) Represent RSIC before the South Carolina General Assembly and/or any of its committees or sub-committees and any State agencies with assistance from the CIO and/or COO as necessary or appropriate.
- (3) Develop and maintain communications and relationships with other state agencies, public retirement systems, stakeholder groups, legislative authorities and other organizations involved with or having an impact on public retirement issues that may affect the Retirement Systems.
- (4) Manage the RSIC in accordance with the operating policies established by the Commission and in compliance with state and federal laws and solicit advice from counsel and the Commission as necessary.
- (5) Appoint and remove non-“Named” service providers in accordance with the Service Provider Selection Policy.
- (6) Oversee and manage recruiting, hiring, terminating, and retaining staff necessary to effectively and prudently manage the RSIC.

**(C) Executive Director Responsibilities: Monitoring and Reporting**

- (1) Ensure that the Commission is provided with relevant, appropriate, and timely information to enable it to properly carry out its investment, management, monitoring and oversight responsibilities.
- (2) Coordinate reporting requirements to RSIC and other stakeholders.
- (3) Monitor that the RSIC operates within applicable laws, rules, regulations, and policies at all times.
- (4) Monitor proposed changes in state and federal laws and, in consultation with legal counsel and/or Staff, analyze and evaluate proposed legislation affecting the RSIC or Retirement Systems’ investments; when appropriate, develop and recommend to the

Commission an official position for RSIC, consistent with RSIC's role and strategic direction.

- (5) Oversee, observe, and delegate to the CIO and COO, as appropriate and consistent with Commission policies and state law.
- (6) Ensure Human Resource procedures are implemented and adequate to monitor, mentor, develop and evaluate the performance of staff (excluding the CIO and staff reporting directly to the Audit and Enterprise Risk Management Committee).
- (7) Ensure the Commission receives recommendations for approval or dismissal of named service providers in accordance with the Service Provider Selection Policy.
- (8) Ensure the implementation of appropriate internal controls.
- (9) Monitor and direct counsel with respect to legal actions involving RSIC, keeping the Commission apprised of such actions, and when necessary, obtaining Commission approval before undertaking such actions.
- (10) Ensure internal and external audits are performed as needed and findings are appropriately addressed.
- (11) In collaboration with the CIO and COO execute a management representation letter from RSIC to the South Carolina Public Employee Benefit Authority ("PEBA") to be used in conjunction with the preparation of the annual financial statements and the annual external audit thereof. Appropriate representations should be made regarding the investment portfolio functions of the RSIC.
- (12) Execute any management representation letters or audit engagement letters for engagements concerning the RSIC conducted by the State Auditor's Office.
- (13) Coordinate implementation and compliance of audit findings and recommendations at the direction of the Audit Committee.

**(D) Chief Investment Officer Role**

- (1) Serves as chief investment officer, reporting to the Commission, for functions and duties provided by [Title 9, Chapter 16 of the Code of Laws of South Carolina](#), 1976, as amended, and as appropriately delegated by the Commission, and reporting to the Executive Director for day-to-day oversight and strategic planning objectives. The CIO serves as the central source of authority and accountability for all investment decisions delegated to him by the Commission or state law.
- (2) The Chief Investment Officer ("CIO") is an at-will employee, selected by the Commission, who is a fiduciary pursuant to State law, and must discharge his duties consistent with fiduciary standards at all times. ([§§9-16-315\(G\)](#), [9-16-10\(4\)](#), [9-16-40](#))
- (3) Supports the Commission at all times in discharging its duties.

**(E) CIO Responsibilities: General**

- (1) Assist the Executive Director when the Executive Director represents the RSIC before the South Carolina General Assembly and/or any of its committees or subcommittees and any State agencies related to investment matters.
- (2) Develop investment business plans for incorporation into the RSIC strategic plan by the Executive Director.
- (3) Monitor and evaluate the activities and performance of staff designated as investment staff on RSIC's most current organizational chart.
- (4) Annually, as part of the budget request proposal, present a plan to the Commission to recruit, hire, and retain personnel necessary to effectively manage the RSIC's investment related functions.

- (5) Annually present a summary of investment FTEs, if any are included in the approved final budget, and the estimated salary range for each position, to the Commission.
- (6) Monitor and evaluate the activities and performance of external service providers engaged by RSIC or the Commission for investment functions, including contracts, mandates, and performance expectations and results. *See Service Provider Selection Policy*
- (7) Manage personnel under his or her direction based on the organizational chart; recruit, hire, terminate, and retain staff necessary to effectively and prudently manage the investment function of the RSIC, all of which shall be in collaboration with the Executive Director and in accordance with the strategic plan and approved budget.

**(F) CIO Responsibilities: Investment Policy**

- (1) Develop and recommend to the Commission, Committees, and Staff, sound principles, policies, and guidelines for the investment and management of the Retirement System's assets and the Commission's underlying strategic allocations to be used to achieve RSIC objectives.
- (2) Advise the Commission on investment matters and make recommendations for Commission action.
- (3) Coordinate and/or conduct all necessary initial and ongoing due diligence relating to the engagement of investment managers, consultants, and providers of investment services involving the RSIC.
- (4) Invest, manage, and direct the investment strategies and plans approved by the Commission, including reviewing the performance of the investments and execute the Commission's portfolio rebalancing policy.
- (5) Review all investment policies of the Commission and recommend appropriate policies and/or procedures to ensure efficient investment operations of the RSIC.
- (6) Develop a proposed annual investment plan ("AIP") and submit the proposed AIP to the Commission no later than April first of each year. ([§9-16-320\(A\)](#)). In developing the AIP, the CIO shall diversify the investments of the Retirement System (unless the Commission reasonably determines that, because of special circumstances, it is clearly not prudent to do so) and make a reasonable effort to verify the facts relevant to the investment of the assets of the Retirement System. ([§9-16-330\(C\)](#)) The AIP must be consistent with the Commission's statement of general investment objectives and with that statement of actuarial assumptions developed by the Retirement System's actuary and approved by the South Carolina Budget and Control Board ([§9-16-330\(A\)](#)), and must include, but is not limited to, the following components:
  - (a) General operational and investment policies;
  - (b) Investment objectives and performance standards;
  - (c) Investment strategies, which may include indexed or enhanced indexed strategies as the preferred or exclusive strategies for equity investing, and an explanation of the reasons for the selection of each strategy;
  - (d) Industry sector, market sector, issuer, and other allocations of assets that provide diversification in accordance with prudent investment standards, including desired rates of return and acceptable levels of risks for each asset class;
  - (e) Policies and procedures providing flexibility in responding to market contingencies;

- (f) Procedures and policies for selecting, monitoring, compensating, and terminating investment consultants, equity investment managers, and other necessary professional service providers; and
- (g) Methods for managing the costs of the investment activities. ([§9-16-330\(B\)](#))

**(G) Chief Operating Officer Role**

- (1) Serves as a fiduciary of the RSIC, reporting directly to the Executive Director, with functions and duties as assigned by the Executive Director.
- (2) The COO must discharge duties consistent with fiduciary standards at all times.
- (3) The COO is an at-will employee, selected by the Executive Director, responsible for oversight of the reporting, information technology and the administrative operations of the RSIC.
- (4) Supports the Commission at all times in discharging its duties.

**(H) COO Responsibilities: General**

- (1) Monitor and evaluate the activities and performance of staff within his or her chain of command on RSIC's most current organizational chart.
- (2) Provide input to the Executive Director relating to the development of operational strategy plans and business plans for incorporation into the RSIC strategic plan.
- (3) Monitor and evaluate the activities and performance of external service providers engaged by RSIC for non-investment functions, including contracts, mandates, and performance expectations.
- (4) Review personnel, internal operating, and other administrative policies of the Commission and RSIC and recommend appropriate policies and/or procedures to ensure efficient administrative operations.
- (5) Excluding staff reporting to the CIO or directly to the Commission, annually, as part of the budget request proposal, present a plan to the Commission to recruit, hire, and retain personnel necessary to effectively manage the RSIC's administrative functions.
- (6) Excluding staff reporting to the CIO or directly to the Commission, annually present a summary of FTEs, if any are included in the approved final budget, and the estimated salary range for each position to the Commission.
- (7) Inform the Executive Director of pertinent information regarding RSIC administration and Staff and other matters he/she deems appropriate.
- (8) Manage personnel under his or her direction based on the organizational chart, and in collaboration with the Executive Director and in accordance with the strategic plan and approved budget, recruit, hire, terminate, and retain staff necessary to effectively and prudently manage the administrative and operational functions of the RSIC.

**(I) COO Responsibilities: Governance, Commission Operations, and Reporting**

- (1) Prepare and present to the Commission for approval, or amendment as necessary, governance policies or other policies describing roles and responsibilities of the Commission and its Committees.
- (2) Advise the Executive Director on administrative matters and make recommendations for Executive Director action.
- (3) Assist the Executive Director with reporting requirements for RSIC and to other stakeholders.

**(J) Delegation to the Executive Director, CIO and/or COO**

- (1) The Commission may delegate, or revoke the delegation of, any of its functions to the Executive Director, CIO and/or COO as it deems necessary and appropriate for efficient administration, and when such delegation is consistent with South Carolina law.
- (2) In performing a delegated function, the Executive Director, CIO and COO owe a duty to the Retirement System and to its participants and beneficiaries to comply with the terms of the delegation and to comply with applicable law. ([§9-16-40](#))
- (3) Pursuant to a delegation of authority by the Commission, the Executive Director, CIO and the COO shall discharge duties with respect to the Retirement System:
  - (a) Solely in the interest of the Retirement System, participants, and beneficiaries;
  - (b) For the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable expenses of administering the Retirement System;
  - (c) With the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of a like character and purpose;
  - (d) Impartially, taking into account differing interests of participants and beneficiaries;
  - (e) Incurring only costs that are appropriate and reasonable; and
  - (f) In accordance with a good faith interpretation of [Title 9, Chapter 16 of the Code of Laws of South Carolina](#), 1976, as amended. ([§9-16-40](#))

**(K) Selection and Emergency Succession**

- (1) According to South Carolina law, the Commission employs a chief investment officer to assist the Commission in its investment function. The Commission also has explicit statutory authority to employ other professional, administrative, and clerical personnel it determines necessary. ([§9-16-315\(G\)](#))
- (2) Executive Director. In the event of a sudden loss of services of the Executive Director, the COO will serve as the Acting Executive Director, responsible for carrying out the Executive Director's duties until such time as the Commission selects a new Executive Director and that person assumes the position on a full time basis.
- (3) CIO. In the event of a sudden loss of services of the CIO, the Commission will appoint a senior member of the RSIC's investment staff to serve as the Acting CIO, responsible for carrying out the CIO's duties until such time as the Commission selects a new CIO and that person assumes the position on a full-time basis.

**(L) Defense and Indemnification**

- (1) The state of South Carolina shall defend the Executive Director, CIO and COO, as management employees of the RSIC, against a claim or suit that arises out of or by virtue of performance of official duties, unless he or she was acting in bad faith, and must indemnify the Executive Director, CIO and/or the COO for a loss or judgment incurred by him or her as a result of such claim or suit, without regard to whether the claim or suit is brought against him or her in his individual or official capacities, or both. ([§9-16-370](#)).
- (2) The commitment of the state of South Carolina to defend and indemnify extends to the Executive Director, CIO and COO of the RSIC after he or she has left employment with the RSIC, if the claim or suit arises out of or by virtue of his or her performance of official duties on behalf of the RSIC. ([§9-16-370](#))



**(M) Gender References, Policy Review and History**

- (1) Any gender-specific language in this policy shall include the other gender.
- (2) The Commission will review this policy at least every three years to ensure that it remains relevant and appropriate, or when there has been an amendment to applicable law relevant to any section of this policy, or a Commission approved change in the responsibilities, duties, or operations of the Commission or its Committees generally, or as otherwise deemed appropriate by the Commission.
- (3) No provision of this policy shall apply to the extent that it is in conflict with any provision of the Code of Laws of South Carolina, 1976, as amended. In the event of such conflict, the applicable Code provision shall apply in all respects.
- (4) This policy was adopted on August 20, 2009.
- (5) This policy was amended on September 17, 2011.
- (6) This policy was amended on February 28, 2013.
- (7) This policy was last amended on DATE



## Audit Committee

- I. **Definitions.** For purposes of this charter, the following capitalized terms will have the defined meaning set forth below:
  - (A) “Commission” means the commission of seven members responsible for managing the South Carolina Retirement System Investment Commission, as specified in S.C. Code of Laws Ann. §9-16-315.
  - (B) “Management” means the South Carolina Retirement System Investment Commission staff members in senior or executive roles, or who may be designated as such on the organizational chart of the agency.
  - (C) “South Carolina Retirement System Investment Commission” or “RSIC” means the agency established by South Carolina law for the purpose of investing and managing all assets held in trust for the participants and beneficiaries of the state’s five separate defined benefit plans.
  
- II. **Purpose of the Committee.** The Commission has established an Audit Committee to oversee the internal audit ~~and, enterprise risk management, and~~ compliance functions, as well as the internal control environment and any engagements with external audit firms.
  
- III. **Primary Responsibilities:**
  - ~~(A)~~ Overseeing the enterprise risk management, compliance and control activities of the RSIC Company, including without limitation the development and execution by management of strategies to mitigate risks
  - ~~(A)(B)~~ Overseeing the risk assessment process conducted by the Enterprise Risk Management and Internal Audit and Compliance Department departments.
  - ~~(C)~~ Approving, periodically, the audit plans of the Internal Audit and Compliance Department.
  - ~~(B)(D)~~ Assessing, and providing oversight to management relating to the identification and evaluation, of major strategic, operational, regulatory, information and external risks inherent in the business of the RSIC Company (the “Risks”) and the control processes with respect to such risks.
  - ~~(C)(E)~~ Reviewing, periodically, the findings of internal audits and approving any necessary follow up items or recommendations to be conducted by the Director of Internal Audit and Compliance or Management Chief Audit Officer.
  - ~~(D)(F)~~ Monitoring the implementation of any approved follow up items or recommendations.

~~(E)~~(G) Overseeing the process for monitoring compliance with RSIC policies and applicable laws, including but not limited to: ethics requirements and standards of conduct.

#### IV. **Composition**

- (A) The Audit Committee will consist of three members of the Commission.
- (B) The Commission will appoint Committee members -in accordance with the Committees Policy of the Commission.
- (C) The Committee Chair will be selected by vote of the Committee.
- (D) The Executive Director of the Public Employee Benefit Authority, serving as a Commission member ex officio, will be a member of the Commission's Audit Committee.

#### V. **Meetings**

- (A) The Audit Committee will meet at least four times a year and has the authority to convene additional meetings as circumstances require, so long as notice is provided as appropriate and in accordance with the South Carolina Freedom of Information Act ("FOIA").
- (B) In accordance with FOIA, the Committee must give written public notice of their regular meetings at the beginning of each calendar year. The notice must include the dates, times and places of the meetings.
- (C) The annual schedule may be modified by the Audit Committee as necessary.
- (D) All Committee members should expect to attend each meeting in person or via conference call or video-conference (if available).
- (E) The Committee may invite members of Management, external auditors, internal auditors and/or others to attend meetings and to provide pertinent information, as necessary.
- (F) In the event a Commission member who is not a member of the Audit Committee attends an Audit Committee meeting, he will not have voting rights and will not participate in discussions of the Audit Committee unless asked and if such participation would not create a quorum of the Commission.
- (G) Meeting agendas, notices, and minutes will be prepared and provided in accordance with the Committees Policy of the Commission, FOIA and all other applicable laws.

#### VI. **Authority:** The Committee is empowered to:

- (A) Retain independent counsel, accountants, or other specialists to advise the Committee.
- (B) Seek any information it requires from RSIC's staff, all of whom are directed to cooperate with the Committee's requests, or the requests of external parties working for the Committee.
- (C) Meet with the Commission, RSIC staff, internal auditors, outside counsel and/or specialists, as necessary.
- (D) Appoint (or dismiss), compensate, and oversee the work of the ~~Director of Internal Audit and Compliance~~ Chief Audit Officer in accordance with RSIC's personnel policies and applicable state law, and oversee the work of the Internal Audit ~~and, the Enterprise Risk Management, and Compliance~~ Department functions.
- (E) Ensure that contracts with service providers contain appropriate record-keeping and audit language.
- (F) Communicate with the Commission regarding the RSIC's policies and applicable laws, including ethics requirements and standards of conduct, as each relates to internal control, and all internal auditing activities.
- (G) The Committee may authorize investigations into any matters within its scope of responsibility.

**VII. Detailed Listing of Responsibilities:** The Committee will carry out the following responsibilities:

- (A) **Internal Control.** Provide the policy and framework for an effective system of internal controls, and provide the mechanisms for periodic assessment of the system of internal controls.
- (B) **Internal Audit**
  - (1) Assure and maintain the independence of the internal audit process. The ~~Director of Internal Audit and Compliance~~ Chief Audit Officer will report to the Audit Committee. For administrative purposes, such as approving leave requests, the ~~Director of Internal Audit and Compliance~~ Chief Audit Officer will report to the Chief Operating Officer ("COO") (dotted line).
  - (2) The Committee will evaluate the performance of the ~~Director of Internal Audit and Compliance~~ Chief Audit Officer at least annually. The Committee may confer with the COO, CIO and other members of Management as deemed appropriate by the Committee. Discussions regarding the performance of the ~~Director of Internal Audit and Compliance~~ Chief Audit Officer may be held in executive session in

accordance with state law.

- (3) Ensure that internal auditors have access to all documents, information, and systems throughout the RSIC.
- (4) Review periodically with Management and the ~~Director of Internal Audit and Compliance~~ Chief Audit Officer the charter, objectives, plans, activities, staffing, qualifications, and organizational structure of the internal audit function.

Receive and review all internal audit reports and management letters that are related to the support of external audit opinions or are integral to the system of internal controls.

### **(C) Enterprise Risk Management and Compliance**

- (1) ~~A~~To assure competency and objectivity in the enterprise risk management process. The Director of Enterprise Risk Management and Compliance will report to the Audit Committee. For administrative purposes, such as approving leave requests, the Director of Enterprise Risk Management and Compliance will report to the Chief Operating Officer ("COO") (dotted line).
- (2) The Committee will evaluate the performance of the Director of Enterprise Risk Management and Compliance at least annually. The Committee may confer with the COO, CIO and other members of Management as deemed appropriate by the Committee. Discussions regarding the performance of the Director of Enterprise Risk Management and Compliance may be held in executive session in accordance with state law.
- (3) Review and evaluate management's identification of all major Risks to the business and their relative weight;
- (4) Assess the adequacy of management's Risk assessment, its plan for Risk control or mitigation, and disclosure;
- (5) Review and evaluate management's development and execution of certain risk mitigation strategies and opportunities proposed by management and selected by the Committee for further review; and
- (6) Review, assess and discuss with ~~RSIC Legal~~the General Counsel, the Chief Operations Officer and the Chief Audit Officer; (i) any significant enterprise risks or exposures, (ii) the steps management has taken to minimize such enterprise risks or exposures; and (iii) the ~~RSIC Company~~'s underlying policies with respect to risk assessment and enterprise risk management.
- (7) Provide the policy and framework for compliance with applicable law and provide the mechanisms for periodic assessment of compliance, including

compliance by named and other service providers, consultants, and investment managers.

(8) Review the findings of any examinations by regulatory agencies and any auditor observations.

(9) Review the process for communicating applicable ethics requirements and standards of conduct to the Commission and RSIC staff, and for monitoring compliance therewith.

(10) Obtain regular updates from Management, the Director of Enterprise Risk Management and Compliance, and/or legal counsel regarding compliance matters.

#### ~~(C)~~(D) **Engagements with External Audit Firms** (non-financial statement)

- (1) Review the external auditors' proposed audit or agreed-upon-procedures scope and approach, including coordination of effort with internal audit.
- (2) Review the performance of the external auditors, and exercise final approval on the appointment, retention or discharge of these auditors.
- (3) Pre-approve the scope of all services to be performed by the external auditor.
- (4) Review and approve the reports of the audits and/or agreed-upon-procedures.
- (5) Provide a forum for follow up of findings from the audit reports or agreed-upon-procedures.

#### ~~(D)~~ **Compliance**

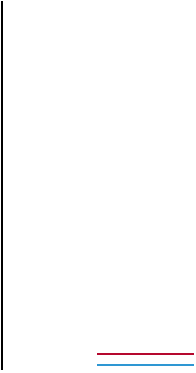
- ~~(5) Provide the policy and framework for compliance with applicable law and provide the mechanisms for periodic assessment of compliance, including compliance by named and other service providers, consultants, and investment managers.~~
- ~~(7) Review the findings of any examinations by regulatory agencies and any auditor observations.~~
- ~~(8) Review the process for communicating applicable ethics requirements and standards of conduct to the Commission and RSIC staff, and for monitoring compliance therewith.~~
- ~~(9) Obtain regular updates from Management, the Director of Internal Audit and Compliance, and/or legal counsel regarding compliance matters.~~

~~(H)~~(E) **Reporting Responsibilities** Regularly report to the Commission about Committee activities, issues, and related recommendations.

~~(K)~~(F) **Other Responsibilities**

- (1) Perform other activities related to this charter as requested by the Commission.
  - (2) Review and assess the adequacy of the Committee charter at least every three years, requesting Commission approval for proposed changes.
  - (3) Confirm annually that all responsibilities outlined in this charter have been carried out.
  - (4) Evaluate the Committee's and individual Committee member's performance on a regular basis.
- Provide an appropriate and confidential mechanism for whistleblowers to provide information on potentially fraudulent financial reporting, cases of fraud, or other material breaches of internal control to the Committee.

(5)



**To: Members of the Commission**

**From: Compensation Committee**

**Date: April 22, 2014**

**Re: Report for May 1, 2014 Commission Meeting**

The Compensation Committee (the “Committee”) met on April 9, 2014. The Committee, in light of certain recommendations made in the fiduciary audit, reviewed and submits the following recommendations to the Commission relating to the Committee charter:

- 1) Add human resources as an oversight function of the Committee. As compensation and human resources matters are inherently linked, and pursuant to the recommendation in the fiduciary auditor’s report, the Committee believes the addition of human resources oversight is important to the role of the Committee.
- 2) As part of its responsibilities, the Committee would like to adopt the fiduciary auditor’s recommendation that the Committee i) annually reviews RSIC’s implementation of the Compensation Policy and ii) conducts or procures a new peer compensation study as least every three years to assess the current level of RSIC staff compensation and make revisions to target salary ranges as appropriate.
  - a. **Motion:** Compensation Committee recommends that the Commission approve the Compensation Committee Charter as amended and presented.



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## Human Resources and Compensation Committee

### **I. Definitions.** For purposes of this charter, the following capitalized terms will have the defined meaning set forth below:

- (A) “Commission” means the commission of seven members responsible for managing the South Carolina Retirement System Investment Commission, as specified in S.C. Code of Laws Ann. §9-16-315.
- (B) “South Carolina Retirement System Investment Commission” or “RSIC” means the agency established by South Carolina law for the purpose of investing and managing all assets held in trust for the participants and beneficiaries of the state’s five separate defined benefit plans.

### **II. Purpose of the Committee.** The Commission has established a Human Resources and Compensation Committee (“HR and Compensation Committee” or the “Committee”) to consider and make recommendations to the Commission concerning matters relating to the compensation of the Chief Operating Officer (COO) and Chief Investment Officer (CIO) and the RSIC staff and to provide oversight relating to human resources.

### **III. Primary Responsibilities**

- (A) Reviewing and making recommendations related to the RSIC’s Compensation Policy, including sections related to Performance Incentive Compensation (“PIC”) to ensure the RSIC can recruit and retain superior talent to satisfy the core mission of the Commission.
- (B) Providing oversight of human resources.
- (C) Providing guidance to staff on human resources and capability development.
- (D) Conducting an annual review of the RSIC’s implementation of the Compensation Policy.
- (E) Conducting or procuring a new peer compensation study at least every three years to assess the current level of RSIC staff compensation and make revisions to target salary ranges, as appropriate.

### **IV. Composition**

- (A) The Compensation Committee will consist of three members of the Commission.

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- (B) The Commission will appoint Committee members and the Committee Chair in accordance with the Committees Policy of the Commission.

**V. Meetings**

- (A) The HR and Compensation Committee will provide notice of its meetings in accordance with the South Carolina Freedom of Information Act (“FOIA”).
- (B) In the event a Commission member who is not a member of the HR and Compensation Committee attends a Compensation Committee meeting, he will not have voting rights and will not participate in discussions of the Compensation Committee.
- (C) Meeting agendas, notices, and minutes will be prepared and provided in accordance with the Committees Policy of the Commission, FOIA and all other applicable laws.

**VI. Authority.** The Committee is empowered to:

- (A) Recommend to the Commission the retention of consultants or other resources needed by the Committee to carry out its primary responsibilities.
- (B) Meet with and seek information from the Commission, RSIC staff, consultants, and/or other subject matter specialists, as necessary to carry out its primary responsibilities.

**VII. Reporting Responsibilities.** Report to the Commission about Committee activities, issues, and related recommendations as appropriate.

**VIII. Other Responsibilities**

- (A) Perform other activities related to this charter as requested by the Commission.
- (B) Review and assess the adequacy of the Committee charter at least every three years, requesting Commission approval for proposed changes.
- (C) Confirm annually that all responsibilities outlined in this charter have been carried out.
- (D) Evaluate the Committee's and individual Committee member's performance on a regular basis.